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U.S. INDUSTRIAL STRATEGY

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HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

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CONTENTS

STATEMENTS

	Page
Byrom, Fletcher L., retired chairman of the board, Koppers Co., Inc	11
Levin, Hon. Carl, a U.S. Senator from the State of Michigan	73
Magaziner, Ira C., president, Telesis	34
Oswald, Rudolph, director, Department of Economic Research, American Federation of Labor and Congress of Industrial Organizations	77

ADDITIONAL INFORMATION SUBMITTED FOR THE RECORD

Byrom, Fletcher L., prepared statement	14
Fraser, Douglas A., president, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), statement	106
Levin, Hon. Carl, prepared statement	75
Lundine, Hon. Stan, opening statement	2
Magaziner, Ira C., prepared statement entitled "New Policies for Wealth Creation in the U.S."	41
Oswald, Rudolph, prepared statement	80
Watts, Glenn E., president, Communications Workers of America, statement on a proposal for a national industrial development board (H.R. 6009)	6
U.S. Council for an Open World Economy, statement submitted by David J. Steinberg, president	113

U.S. INDUSTRIAL STRATEGY

WEDNESDAY, SEPTEMBER 22, 1982

HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON ECONOMIC STABILIZATION,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m. in room 2220, Rayburn House Office Building; Hon. Stanley N. Lundine, presiding.

Present: Representatives Lundine, William J. Coyne, McKinney, and James K. Coyne.

Mr. LUNDINE. The Subcommittee on Economic Stabilization will come to order. Chairman Blanchard wanted very much to be a part of these hearings and asked me to organize them. However, he is unable to be here, and I will be presiding during most of the hearing.

I would ask unanimous consent to have an opening statement of mine inserted into the record at this point.

[Mr. Lundine's opening statement follows:]

Opening Statement
Cong. Stan Lundine
Hearings on H.R. 6099
Economic Stabilization Subcommittee
September 22, 1982

The United States is faced today with reversing an industrial decline unparalleled in its history. U.S. automobile, glass, steel, rubber and textile industries which over the years have formed the backbone of our manufacturing base are seriously eroded. Promising new domestic growth industries such as computers, semi-conductors, and bio-technologies, are in a battle for their survival against tough foreign competitors who are receiving support from their governments through coordinated industrial strategies. These foreign industrial strategies encompass many policy aspects including targeted investment, regulatory policy, human resource development, and the allocation of research and development dollars.

There are many underlying causes for our current industrial decline. Some of these were inevitable, but others could have been avoided with better foresight and coordination of approach between the public and private sectors of our society. Pointing fingers and assessing blame, however, will get us nowhere. The truth is that there is plenty of blame to go around--to government, to management, to labor, and to others in our society.

We are here today to discuss solutions to our economic problems. Over the past two years, we have experimented with the application of a combination of supply-side and monetarist macro-economic policies that have thus far failed to give rise to economic revitalization. To the contrary, these macro-economic policies, combined with a de-emphasis on federal involvement in addressing the structural problems of our economy, have led to record business failures, falling business investment, a perpetuation of high interest rates, a ballooning federal deficit, and the largest number of Americans unemployed since the Great Depression.

It is clear that macro-economic policy prescriptions are not, by themselves, sufficient. They must be combined with a coherent industrial strategy for revitalizing our economy. Like it or not, we are living today in an economy where the market does not always function perfectly. Indeed, our economy no longer operates as an entity in itself. Rather, it is affected and conditioned by the interdependent nature of the global economy and intense international competition.

I believe that the United States must develop a coherent industrial strategy. Such a strategy must be based on a consensus between government, business, labor, and the public interest if it is tosucceed in addressing our economic problems. For this reason, I have introduced H.R. 6099, to establish a National Industrial Development Board to formulate recommendations for such a policy based on consensus foundations.

Let me make it clear that I am not proposing the establishment of a "U.S., Incorporated". Nor am I proposing the establishment of an agency to pick "winners" and "losers". What I am suggesting is that the United States must begin to break down the traditional adversarial and confrontational approach to our economic problems that has been asserted in the past.

We need a new institutional mechanism for problem-solving in this country. The development of consensus through cooperation can bring enlightened and innovative policy suggestions to the forefront of the debate in Congress and form the basis for consideration of long-term investment strategies in the private sector.

Every major industrial nation of the world except the United States is engaged in an effort to refine an industrial policy. We have all read "ad nauseum" about the effectiveness of Japan's M.I.T.I., and to a lesser but nonetheless significant degree,

of efforts ongoing in Scandinavia, Germany, and France. These nations show no signs of abandoning their targeted industrial strategies and returning to an international laissez-faire competition. Under these circumstances, it is unrealistic to expect the United States to survive as the leading industrial nation very long unless we develop our own brand of industrial policy.

We are privileged today to have with us expert witnesses to examine the challenge facing our country as we attempt to revitalize our economy. We will hear from a representative from each of the four segments of society which would form a cooperative team under H.R. 6099. First, we will hear from government. My good friend, Senator Carl Levin, who has taken the leadership on this issue in the Senate will give us his views. Next, we will hear from Ira Magaziner, who is President of Telesis, and in this capacity has served as a consultant to business, government, and labor on these issues. He is the co-author of the widely read new book on this subject, Minding America's Business. Third, we will hear testimony from Fletcher Byrom, distinguished former Chairman of the Koppers Company, and now Chairman of the Committee for Economic Development, and organization representing 200 of our nation's most important businesses and universities. Finally, we will hear testimony from Rudy Oswald, from the AFL-CIO, who will present labor's thoughts on this issue. Before moving to our first witness, I must first ask for unanimous consent to insert the testimony of Glenn Watts, President of the Communication Workers of America in the record. Mr. Watts wanted to testify in person, but was unfortunately prohibited from doing so by previous commitments.

Mr. LUNDINE. Briefly, I would just like to welcome everyone, and particularly the witnesses who are here.

The United States is facing an industrial decline probably unparalleled in our history. Not only the automobile, glass, rubber, steel, and textile industries which have formed the backbone of our manufacturing base in the past, but even new growth industries such as computers and semiconductors are in a battle for survival against tough foreign competitors.

This subcommittee during this Congress has held previous hearings on the subject of industrial policy and has received very thought-provoking and interesting information. We feel, though, that it is crucial to keep abreast of the best thinking in this area. It may be necessary, possibly even before the expiration of this Congress, to take some action to try to develop a more coherent Federal response to this industrial decline.

Macro-economic policies are important, but are clearly not the total answer to revitalizing American industry. The hearing today is not focused on an individual bill but rather just on the general subject of what the industrial strategy of the United States should be.

Nevertheless, I have introduced bill H.R. 6099, suggesting that we should establish a national industrial development board. This would not be to pick winners and losers, but rather to try to develop a mechanism for consensus and cooperation in terms of long-term investment strategies and Government policies designed to complement them.

The witnesses we will hear from today include Ira Magaziner, who is president of Telesis in Rhode Island, and serves as a consultant to many international businesses and governments. He is the co-author of the widely read new book entitled "Minding America's Business."

We will also have Fletcher Byrom, the distinguished former chairman of Koppers Co. in Pittsburgh and now chairman of the Committee for Economic Development.

And we will hear testimony from Rudy Oswald of the AFL-CIO.

I would also like to ask unanimous consent that a statement from Glenn Watts, president of the Communication Workers of America, be entered into the record. Without objection, I will enter Mr. Watts' statement into the record of the hearing at this point.

[The statement of Mr. Watts follows:]

STATEMENT ON A PROPOSAL
FOR A NATIONAL INDUSTRIAL DEVELOPMENT BOARD (H.R.6009)
BY GLENN E. WATTS, PRESIDENT
COMMUNICATIONS WORKERS OF AMERICA

I am glad for this opportunity to express the support of the Communications Workers of America for this legislation proposed by Representatives Lundine, Hamilton, and Bonior. It is based, as I see it, on a simple premise: that policy is best made by full and informed discussion among those who are directly concerned with the issues. As a major labor union representing over 600,000 workers in the telecommunications industry and the public sector, we at the Communications Workers of America feel that the time has finally come for this eminently sensible idea.

Of course, this approach runs counter to much of the tradition of economic activity in the U.S. We are more used to making policy by accident: one party (usually the business community) makes a move, and the others (labor, government and community groups) react according to their own concerns. The outcome of this free-for-all is what we call economic policy.

The costs of this lack of coordination have become increasingly apparent during the present recession. Our laissez-faire approach to industrial policy is in sharp contrast to the policies of our competitors in Europe and Japan and no longer serves us well. In an atmosphere of economic stagnation, it is intolerable for private corporations unilaterally to make decisions at the expense of the rest of society. Such actions sow discord and ultimately undermine our economic structure.

Decisions made in boardrooms based upon the sole interests of the firm have an impact far beyond the parochial concerns of the businessmen making them. Yet today management, slighting the legitimate needs of workers and communities, has adopted more and more limited, short-run perspectives which are hindering economic growth. This is the conclusion of no less than the Harvard Business Review, in a well-known article by Professors Hayes and Abernathy. They cite a Japanese observer who comments:

> "Instead of meeting the challenge of a changing world, American business today is making small, short-term adjustments by cutting costs and by turning to the government for temporary relief."

Examples of this short-sightedness abound: the near-collapse of Chrysler, for instance, commanded the nation's attention precisely because the viability of regions, cities, communities, and families was at stake, not just the survival of a corporate entity. The economic problem created in the privacy of Chrysler's corporate boardroom, spilled onto Main Street and threatened entire communities. The industrial problems of Chrysler were not isolated corporate problems, but ones intimately connected to the daily lives of hundreds of men and women.

Beyond these short-term crises lie deep economic changes which will profoundly affect large portions of our society. In our own industry -- telecommunications -- we are seeing vast changes in the technology and structure of the business and in its market position. These changes in turn have opened up new frontiers and created new opportunities as well as problems. Fundamental industrial changes have already forced a reexamination of the framework of the telecommunications industry along several fronts -- through the courts, the Federal Communications Commission and in Congress -- and have led to major policy debates in these halls.

Beyond our industry lie increasingly severe problems which cry out for coordinated planning. The decline of old manufacturing industries, the rise of electronics, the growing importance of energy conservation -- these will involve significant job and community dislocation. Responsible planning is essential to eliminate the hardships which such adjustments would otherwise occasion for workers and their families when overall needs for personnel or for specific skills are drastically altered. The need for planning is heightened by the probability that the impact is likely to be decidedly uneven, with certain industries much more heavily affected than others. On the other hand, these changes will also create new employment opportunities for individuals, communities and regions to create a new future.

Public policymakers should therefore be expected to make a good-faith effort to assess the job implications of economic strategies. Greater knowledge of potential job impacts would allow planning to increase favorable employment effects and decrease adverse ones. Such anticipatory actions could eliminate the need for after-the-fact dislocation assistance, identify areas of substitute employment, and design training programs to fill changing occupational requirements.

Our industrial policy should also focus on macro-economic goals for the economy. The overriding objective would be to create a strong full employment economy which contributes to the quality of life of Americans and promotes a higher standard of living. Our focus should be on long-term economic growth which assures a job for every American. Without full employment, any industrial policy we choose must be considered incomplete. Economically, a full employment policy is critical to generate sufficient demand to power our economy.

To suggest, in this period of conflict, that business, labor, government, and consumers can work out differences in a spirit of mutual respect requires something of a leap of faith. I am sure some of my colleagues in the labor movement would not be willing to make it. But I see some reasons to think that faith may be justified.

In the history of this country, there have been a number of partial successes in establishing multipartite planning boards, especially in times of crisis -- the best-known being the War Production Board during World War II. There is no doubt that these bodies helped a great deal

in coordinating the extraordinary effort required by the war. More recent, though farther from home, is the record of joint policymaking agencies among our allies in Europe and Japan. We are seeing that many of the nations which are giving us the stiffest economic competition have some means of coordinating the various parties. I am not talking of central planning mechanisms administered by an expert bureaucracy, but of something very much like what is envisioned by this bill: a voluntary forum for discussion and negotiation among the key actors.

My own faith in the process, moreover, has been increased by recent developments in my union, especially in our relation to our major employer, AT&T. In 1980, after a long history of adversarial relations, the Company, AT&T, and we decided to embark on a new course. Our goal was to explore areas of mutual interest in a spirit of joint problem-solving. Three joint committees were formed to supplement traditional bargaining. One has focused on easing technological change; the second on developing a mutually agreed-on system for job evaluation; and the third on creating a process for worker participation in decision-making (which we call "Quality of Work Life").

These joint efforts are based on the same common sense assumptions as the bill under discussion: the notion that adversarial parties can work out certain issues in a problem-solving mode, and that the results will benefit everyone. Though it is too early yet to pass final judgment, we are greatly encouraged by the process so far. In particular, we have made significant progress through the Quality of Work Life process in reducing job pressures and increasing employee involvement on the job - an outcome which should strengthen both the union and management organizations.

These are some of the successes in the area of joint problem-solving, as contemplated by this bill. There have also been many failures. It wasn't long ago that labor withdrew from a policy panel sponsored by President Carter on the grounds that management was not treating the role of unions with full respect. A number of the efforts in Europe have, over the years, run aground on similar reefs. Without going into the details of the successes and failures, I would like to list some of the main lessons we have drawn from the record -- the conditions which must be met if participative policymaking is to work effectively.

- First, the joint procedure must be seen as supplementary to the normal mechanisms of negotiation, rather than replacing them. This is clearly stated in our initial QWL agreement with AT&T.

  No union could conceive of entering into cooperative discussions with management without the confidence that it can rely on adversarial means if necessary. It is in fact this confidence which makes it possible for respectful, constructive interchange to take place.

- Second, any joint effort must be based on goals and principles which are clearly agreed on at the start. These principles provide a framework for trust. In the case of an Industrial Development Board, the goals should include a full employment economy.

- Third, thorough and widespread education is absolutely essential to the process. Many good committees have come to grief because, no matter how sensible their decisions, they worked too much in secret and did not involve their constituents in the process. The Board would have to pay serious attention to presenting the issues to the public in an open way; and each of its members would have to take responsibility for educating his or her own constituents about what is going on.

- Fourth, the body must be truly representative of the interests concerned. The bill under discussion pays due attention to this issue; but I would want to add that its membership might need to be flexible, so that for any given issue the parties most directly involved could be brought into discussion. It would make little sense for the Board to talk about, say, the problems of the rubber industry if there were no representatives of that industry and associated unions among its members.

- Finally, and perhaps most important, the deliberations must start from a base of mutual respect. We in the labor movement have often felt in the past that our concerns were slighted in the narrow push for profits, and the current political climate has not contributed to better relationships. The cycle of adversarial attacks and counter-attacks will never be overcome, however, unless the concerns of workers are given their due.

There are a few key issues I believe, which an industrial development board would need to address in order to draw full involvement from labor:

1. A primary goal of the overall industrial strategy would have to be the maintenance of full employment. We would also expect the Board to address issues of retraining, relocation, and planning plant shutdowns so as to minimize the suffering of unemployment.

2. The approach to strategy must be comprehensive and pragmatically sound. Policies which stress supply-side incentives but ignore demand will fail in practice and will justifiably arouse resentment among the millions of families suffering from declining purchasing power.

3. Productivity must be approached in ways which benefit all, as opposed to the "speedup" techniques common in the past. Fortunately, it is becoming increasingly clear that attention to human needs also makes good business sense. Worker participation efforts greatly contribute to labor productivity and advance notice of technological

change can increase worker effectiveness. An industrial strategy which seeks commitment from those involved must explore these avenues.

4. There are a few other issues of economic policy which are crucial to the concerns of labor, but which may lie outside the jurisdiction of this board. Still, let me mention the importance to us of lowering interest rates -- probably the key step in any program for economic recovery; maintaining needed protection of the health and safety of workers and consumers; and structuring tax policy more closely on the basis of "equality of sacrifice."

These are the sorts of matters which a multipartite development board could address in a new way, generating truly creative approaches from the interaction of the interested parties. In particular, labor has much to offer to the process. I want to emphasize the importance of labor's role in economic growth. Entirely too much attention has been given to the role of capital in increasing our nation's real growth, and not enough emphasis has been put on labor's contribution. Yet investment in plant and equipment has accounted for only about 10 percent of growth over the years, while advances in technological know-how and increased education of the labor force has accounted for over forty-five percent. And even that is a small part of the potential; many studies have confirmed what our members say, that a real unleashing of the creativity of work force could yield enormous improvements in production.

The policies of some of our fiercest economic competitors have shown so far more respect for interests beyond the business community than our own, and they appear to have benefited greatly. As Robert Reich, former Director of Policy Planning at Federal Trade Commission puts it:

> "A narrower differential between the highest and lowest-paid employees; more generous social security, unemployment, and health insurance; a greater degree of job security and job safety; clearer and healthier environments; broader participation in management -- these factors may account for the greater shared commitment to productivity in Sweden, Japan and West Germany. Rather than constituting luxuries to be traded off against productivity, these elements of a more equitable industrial organization may be critical to achieving it."

In other words, it appears that social justice is essential to productivity in an advanced and highly interdependent industrial economy. This is the basic approach which must be taken in economic development in order to bring together the warring factions for our mutual benefit.

It will not be easy to implement the approach envisioned by Congressman Lundine. But the potential for improvement as a result of joint problem-solving is vast, and the crisis facing us in its absence is fearful. We strongly support the goals of this legislation.

Mr. LUNDINE. Mr. Coyne, do you have any introductory comments?

Mr. WILLIAM COYNE. Nothing, Mr. Chairman, except to say welcome from the city of Pittsburgh, to Mr. Byrom, who has served the city well and long. And I see a native Pittsburgher joining us here today, Congressman McKinney.

I want just to say that Fletcher Byrom served with distinction at the Koppers Co. and also serves as vice president of the Allegheny Conference on Community Development. He has been very involved in Rennaissance I and Rennaissance II in Pittsburgh and also serves as board member of the Presbyterian University Hospital and its health center. He has given great service to the city of Pittsburgh, and we are at a loss to see him spending so much time now out of Pittsburgh. Thank you.

Mr. LUNDINE. Mr. McKinney is the ranking minority member on this subcommittee. Did you wish to make any introductory comments?

Mr. MCKINNEY. Just briefly. I would like to congratulate you, Mr. Chairman, for calling these hearings to explore the issue of national industrial strategy. We have worked together in the past on issues like productivity, quality of work life, labor-management cooperation, the defense industrial base, you name it. I think this is a subject that we are both very interested in addressing.

I am delighted to see a fellow Pittsburgher here. I unfortunately was torn away from Shady Avenue at a very tender age, but I have a picture of the house sitting in my office across the way.

I would like to apologize to the witnesses. I have to attend a financial institutions markup on the ominbus banking reform bill. So I must leave, but I will read your testimony with great interest. It is a subject near and dear to my heart. Thank you.

Mr. LUNDINE. Thank you very much.

I had been frankly stalling for Senator Levin's coming. But I think we will go ahead. If the three witnesses will please come forward, I think what we will do is go ahead and invite you to begin your testimony and then possibly ask your indulgence and interrupt you when Senator Levin arrives.

So, Mr. Oswald, Mr. Byrom, and Mr. Magaziner, we have written statements from all of the witnesses. I really appreciate the comprehensiveness of the written testimony that you have presented. I mean that sincerely. I read two of the statements in detail last evening and was studying the third this morning. And I really appreciate the depth you all went to in covering this subject.

I would likewise appreciate it if you would summarize your remarks. Your entire testimony will be made a part of this record. And we would appreciate if you would summarize your remarks this morning.

I think we will start with Mr. Byrom.

STATEMENT OF FLETCHER L. BYROM, RETIRED CHAIRMAN OF THE BOARD, KOPPERS CO., INC.

Mr. BYROM. Thank you, Mr. Chairman. I am not only pleased and privileged to be here, I am excited that what to me have been very obvious failings in our industrial system for a long time are

being addressed in a very professional and knowledgeable manner. I guess I feel better about the considerations taking place in this hearing and in your committee than I have about anything that Congress has done in this respect for a long time.

As you said, I have submitted written testimony, and I do not intend to do anything other than to say that I have read your analyses of our problems, and I come down foursquare with you as to what the nature of our problems are.

I think that what you are saying about the need for change is consistent with my beliefs. Frankly, this is not the first time this has happened to me. I was saying to Mr. Oswald that frequently I find when you are discussing the nature of the problem you can be in complete agreement; you start to move away from each other when you try to decide what you are going to do about the problem.

I have a suspicion from what I have read and what I know of the positions of the other members of the panel that although we are likely to agree almost unanimously on the nature of the problem, we will not be in agreement on how to correct it.

My feeling is that we have gotten to where we are in the United States in terms of a failing industrial base fundamentally as a result of ad hoc approaches to various facets of the total problem. In fact, in response to an OECD questionnaire a few years ago, the U.S. Government, when asked what its industrial policy was, responded with great pride that it had none. That was the official Government response. It said, we respond to crises in various sectors with ad hoc mechanisms.

I submit that that is no longer possible in the world that exists today. But my belief is that the principal cause of our difficulty has been improper interventions into the market system and that fundamentally what we have managed to do for at least the last 20 years is deny the market system its ability to operate.

And again, we have done it with a whole series of ad hoc approaches, actions which impact upon the industrial base by reducing its ability to modernize and expand. In trying to correct the problem, we diminished the viability of the economic system, because policies were considered in the total context.

I must say that I am not sympathetic to the creation of a Federal-based national board which would attempt on a quadripartite or tripartite basis—quadripartite, I suppose, is more appropriate—to be the determining factor in what is best for our economic society. I am highly sympathetic to the concept if, rather than being legislatively mandated, it is the result of a common perception of crisis and results voluntarily at regional or local levels.

I know, Mr. Chairman, of the experience in Jamestown and what was done there. I think that is the kind of thing we need. To Mr. Coyne, my Congressman, I would say that a voluntary effort to arrive at a regional agreement as to what is needed not in Pittsburgh but for the whole region, which might include pieces of West Virginia and Ohio, is very desirable.

I am disturbed, though, at decisions which say that you ought to try to save a failing operation when economic discontinuity occurs due to technological change. I think a large part of our problem is

due to trying to use social and political concerns as criteria in economic decisionmaking.

I was telling the gentlemen I came over here with that 3 years or so ago I was lecturing at Youngstown State University at the time they were trying to save the steel industry there. And on a television program with a local religious coalition, I told them that the best thing that could happen for Youngstown was for the steel industry to leave. And I almost got run out of town.

But our problems are to deal with economic discontinuities, not how to prevent them from happening, because they will happen. Why do I not just stop here and leave the rest of my discussion to the question-and-answer period so that I do not take time away from my associates on the panel.

[The prepared statement of Mr. Byrom follows:]

STATEMENT

of

FLETCHER L. BYROM
Retired Chairman
Koppers Company, Inc.

and

Chairman of the Board of Trustees
Committee for Economic Development

on

U.S. Industrial Strategy

before

SUBCOMMITTEE ON ECONOMIC STABILIZATION
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

September 22, 1982

Mr. Chairman, my name is Fletcher L. Byrom and until my recent retirement I served as Chairman of Koppers Company, Inc. I now serve in a number of capacities, one of which is Chairman of the Committee for Economic Development, a nonprofit, research and policy organization that draws on the active participation of 200 corporate and academic leaders.

I welcome the opportunity to present my views on the subject of an industrial policy. As you know, I do not intend to comment specifically on the provisions in your bill, although I will make some general observations as I proceed.

It was almost two years ago to the day that I enjoyed a similar opportunity to testify before the Subcommittee on the Cities. At that time I argued that we needed to end the "ad hoc" approach which is characteristically our response to economic problems. I emphasized that a coordinated effort was needed to assure that all parts of our policies, even though developed seperately, relate to each other as part of a more explicit industrial strategy. While some policy components of an industrial strategy have been implemented since then, I remain convinced that we have yet to recognize the need for coherent thought and actions.

Although I may be repetitious, let me recapture the essential points of that prior testimony and then elaborate. I draw on several years of effort by CED to develop specific suggestions in numerous areas that bear on my testimony, including recommendations we have made to reduce inflation; stimulate capital formation; encourage technological advancement; control government expenditure; improve government regulatory practices; increase energy independence, supply, and conservation; and encourage private cooperation at the local level and others.

I also will reflect some of the preliminary work associated with our current effort to develop specific recommendations in the area of productivity and extensive work by our Subcommittee on Industrial Strategy and Trade aimed at the development of a set of recommendations. Under the chairmanship of J. Paul Lyet, former Chairman of Sperry Corporation and presently Chairman of the President's Export Council, this Subcommittee will examine a large range of industrial strategy issues. This policy statement, however, will not be completed until sometime next year. Consequently, I am not able to express the official position of the CED on this subject. However, my own views tend to reflect the general thinking of my colleagues. For your information, I have included in an appendix to my testimony a description of the subcommittee's efforts.

Mr. Chairman, the "ad hoc" approach we as a nation have taken to address our economic troubles has shown no overall comprehension of the complexity and interdependence among the various facets of our socio-economic system. These "ad hoc" policies may have provided some political and economic palliatives, but these have frequently failed to address our fundamental problems facing the economy. We need to restore the flexibility and stability that, in my opinion, can only be provided by a strong market system.

In general I believe that an industrial strategy requires a coordinated set of general policies that together create the environment where economic determinations for all industries and regions are made by the market rather than by government intervention. I do not suggest that the market system can deal entirely with all questions of lifestyle standards. But it is the best economic mechanism for creating the underlying societal wealth so essential to underwriting our nation's aspiration for further improvement in lifestyle.

Such an industrial strategy would include a careful enunciation of the role of the government at all different levels -- federal, regional, state, and local -- in areas such as education, addressing the needs of the disadvantaged and the handicapped, delivery of quality health care at affordable costs, maintenance of an acceptable public infrastructure, standards dealing with quality of the environment, employment opportunities, and safety in the work place.

I use the term industrial strategy to distinguish from an "industrial policy" which for example attempts to "pick winners" or to provide government support for declining regions in industries, or the establishment of a national system of quadripartite labor-management governing boards. I recognize that at the present time this is the approach taken in H.R. 6099. To be sure, cooperative tripartite or quadripartite efforts at some level below the national level could be useful, but only if it emanates from a voluntary desire by the key public and private leaders at the local level to define and address their local problems. I do not believe such a process will work if legislatively mandated by the federal government.

The Difficulty of Picking Winners

The notion of "picking winners," or as some call it a sectoral approach has been popularized by the apparent success of the Japanese Ministry of International Trade and Investment (MITI). The success of the MITI must be understood in the context of recent Japanese economic history and cultural differences, which are significant enough for me to conclude that there is no way we could adopt the MITI approach in this country.

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Historically, there is no evidence that the U.S. government has shown the capability of choosing industries and technologies offering the greatest promise. In a world where rapidly changing technology, resource availability, and the resulting increase in the economic and societal aspirations of citizens of all nations has forged an increased interdependence among nation states, any U.S. industrial strategy needs to be sufficiently flexible and dynamic to capably respond to these ongoing changes in the world economic system. An industrial strategy needs to anticipate change -- I call it 'anticipatory analysis" -- which cannot work if it involves a highly rigid institutionalized approach. Such rigidity would be characteristic of the kinds of bureaucratic organizations mandated by law to select those sectors of the economy which are to be the beneficiaries of government intervention.

To my way of thinking such a rigid approach is likely to result in the wrong industries being chosen, the inefficiencies being compounded, and the continuing inability of the nation to succesfully meet its economic and social objectives.

The Difficulty in Assisting Industries and Regions "In Trouble"

The second notion which concerns me is assiting industries and local areas "in trouble." We are all concerned with industries and regions that are in severe economic distress. But again, as in efforts to pick winners, there are numerous problems with this approach. Which industries? Which regions? I have always felt that any company has the right to fail, provided it has failed fairly in the market place, and where such failure has not been the result of intervening by ill-informed governmental institutions employing obsolete mechanisms of intervention.

A couple of years ago I participated with Doug Fraser of the UAW, in a forum at Carnegie Mellon University entitled "The Failing Corporation: the Role of Government." The intent of this session, of course, was to discuss what should the government do when faced with the imminent failure of a corporation. Somewhat with tongue in cheek, I chose to be confused by the ambiguity of the subject, and addressed the many means that have been employed by government "to cause failure which otherwise might not have occurred."

Mr. Chairman, we seem eminently capable of holding umbrellas over the weakest of our producers. Our policies permit markets to be occupied by marginal producers and consciously deny the more efficient producers from increasing their market share. In my opinion our policies are still based on outmoded concepts of concentration based on fallacious, non-relevant statistics.

Supporting every company that got into trouble was one of the major reasons the British economy was unable to adjust to its inability to compete internationally years ago. And incidentally, during most of the seventies Britain had an elaborate institutional structure of tripartite industry and regional committees to influence economic development.

Supporting industries and regions in trouble raises equity issues. Why should we support an auto manufacturer while another in the business of manufacturing heavy construction equipment and farm machinery is allowed to verge on bankruptcy? By the same token, why should the federal government favor one region over another? Local communities essentially acting on their own are more likely to be successful in adjusting to economic change. This was the case in Lowell, Massachusetts, which until fifteen years ago was one

of the most depressed and undercapitalized areas in the country. Today it has become a major center for technology and has virtually restructured its economic base. Some of these successful local efforts have benefited from some form of federal assistance. But what is important to point out is that in most of the successful cases, this support was used to expand the availability of capital in the local area to stimulate existing or new business. In Lowell, for example, community leaders established a revolving loan fund which has been available to businesses in the area to modernize or to locate new business. In my view, there is a role for government assistance structured in this fashion, provide 1) it does not discriminate among regions; 2) it is offset in the budget; and 3) enables the local community to determine where it should be directed. But in my view no amount of federal assistance will work without a sincere commitment by local leaders to establish and pursue a commonly agreed on vision for the community. As Congressman Lundine knows, in the case of Jamestown, it is this kind of commitment among labor, management, and the local political leadership that can provide the best catalyst for revitalization.

The Quadripartite Approach

I do not believe that the development of a consensus at the national level between government, business, labor, and "public interests" will result in the appropriate choice of sector to be stimulated. In ranging degrees some European countries have tried this approach. I appreciate why many are attracted to this notion. Consensus building is worthy in its own right. Open and frank communication is an important element of resolving any problem. But I am very suspect that any national group would have the capacity, if given the power to develop the right policies for the economy as a whole.

If empowered to recommend procedural prescriptions such a group no matter how representative, would not have the capability of understanding the vast differences among industries and regions to make policy that would be beneficial to all of them. There is the constant danger that such a group might attempt to make specific recommendations for industries not represented on such a board that have no bearing on the real problems of that industry. It is significant that despite claims of "success" of the European models, none of the countries that have tried such a national system believe it is an important part of their industrial policy. At a recent meeting held last June, the Organization for Economic Cooperation and Development, with Japan, Germany and France as signatories, specifically rejected this approach. Instead, the OECD in its report reaffirmed that the competitive market economy "is normally the best mechanism to marshall responses to social, economic and technological changes, flexibly, constructively and without excess cost."1/

I am not opposed to such consensus building efforts being established such as at the local level, such as occurred in Jamestown and elsewhere. In fact, several recent CED studies have pointed to the need for greater institutionalization of public-private partnership at the local level. Our study, Public-Private Partnership: An Opportunity for Urban Communities, makes a convincing case for having leaders from both the public and private sectors, work together to establish local goals as priorities. Just this past week, CED published a series of case studies of various major urban areas which show that where this

1/ Organization for Economic Cooperation and Development Council at Ministerial Level, Positive Adjustment Policies: Managing Structural Change, OECD, Paris 1982, p.2.

has occurred substantial improvement has resulted in the local economic conditions. It was partly from these findings, as well as from an early set of studies we undertook in 1978, that we recently issued a statement urging the Congress to adopt a similar approach in addressing the needs of the hard-to-employ.

What then do I mean by an industrial strategy? In general it means several things.

- First it means a strategy that the purpose of organizational activity, whether publicly, privately, voluntarily or legislatively mandated, is to assure an ever improving standard of living for all Americans.
- Second, it is a strategy that recognizes that the fundamental mechanism for achieving this goal for the United States is the vitality and ingenuity of our system of private enterprise.
- Third, an industrial strategy should encourage policy which creates the environment for economic growth in all industries and regions where the market, not the government, determines how resources are allocated between such industries and regions.
- Fourth, our policies, whatever their mission, should recognize that the ability to compete requires a market system that is as efficient and adaptable to change as possible, and is subject to the minimum acceptable intervention. In this case the rule of necessity and efficiency should apply in determining the degree of intervention which is acceptable.
- Fifth, any policy directed toward our domestic economy must recognize that we no longer are dealing with just a home domestic market, but that we are now all involved in a world market.

- And finally, any industrial strategy must recognize the proper and legitimate role of government in addressing those needs which the market system cannot fully address on its own. These need to include national defense, public infrastructure, and elements of lifestyles such as quality of education and improving the lot of the disadvantaged and others who through no fault of their own are not equipped to participate in the system, health systems, environmental quality, employment opportunities, occupational safety, and similar concerns that deal with value in lifestyles.

An industrial strategy is a set of policies that serves to assure maximum efficiency and adaptability of the market system. One way to look at such a definition is to review briefly the time when no such strategy existed and the unfortunate economic consequences that resulted.

During the late sixties and seventies we developed a series of policies -- fiscal, tax, regulatory and others -- that rarely took into consideration our industrial needs. These policies not only worked to dry up the capital base, they made it more difficult for the market to function efficiently. For example, in the area of resources, our tax policy during this period rewarded consumption over investment and our failure to control inflation, retarded capital investment even further. We are moving to correct some of the disincentives to save and invest but unless we can continue to reduce government spending and reduce interest rates much further, revitalization of our industries will be retarded if not denied.

In the area of efficiency, regulatory efforts to improve the quality of the environment, particularly in the areas of environment and health safety, were poorly designed, costing industry billions in needless expenditures. The result, capital misallocation, that might otherwise have been available for plant modernization.

Antitrust policy had the effect one might expect from 1890 laws applied to 1980 society.

Energy policy inadvisedly designed to maintain artifically low prices, lulled American industry and individuals into complacency, caused false economic choices and was responsible for the failure to make the necessary adjustments that both the Europeans and the Japanese were accomplishing.

During this period, these and other policies were driven by their own separate and generally desirable missions, be it income transfer, social welfare, environmental control or health and safety. But few were designed with much thought to the cost they would have on American industry in terms of reducing its capability of being that source which produces the underlying societal wealth which allows us to underwrite the social aspirations of contemporary society.

Unwittingly, what we were doing was depriving the market system -- the engine which for almost two hundred years had accounted for our increasing standarad of living and our preeminence on the world economy -- of the support necessary for its survival.

The facts are compelling. From 1960 to 1973, the net amount of plant and equipment provided each U.S. worker increased at an average annual rate of 2.3 percent. Since 1973 this rate has declined to 0.1 percent, and in the past two years has been negative. From 1960 to 1973, we increased our net stock of U.S.

manufacturing plant at an average rate of 1.6 percent, but since 1973, there has been little if any increase.

The results of this decapitalization are well known, and include the continuing decline in productivity, the loss of international competitiveness in key U.S. industries and unacceptable levels of unemployment.

Since 1980 some progress has been made. At least there has been a recognition that the market system needs to be strengthened if it is to function. The 1981 tax bill was a clear step in the right direction, but because of the urgent need to get a handle on our disastrous deficit, it has been scaled back. In some respects I feel that the latest tax increases will only delay the expansion of the capital stock we so desperately need to fuel our economic recovery. Nevertheless, even with the retrogressions contained in the latest tax increase, when taken together the two bills move to shift from the consumption bias in the tax code and provide greater incentives for investment, albeit insufficiently by my way of thinking.

What distresses me about the tax bills enacted this session is that tax policy continues to be viewed outside the context of an overall industrial strategy. The tax code continues to represent a hodge-podge of conflicting and confusing provisions, many of which contradict each other. I am becoming more and more convinced that what we need is substantial tax simplification for individuals and corporations. Such a simplification, which I believe can be done without any loss of revenue, would open all investment decisions to the test of the market place.

A second area that fails to meet the test, despite some avowed progress, is regulatory reform, particularly in the areas of air and water and health and safety. Several years ago in Redefining the Government's Role in the Market System CED urged that we move to the use of reasonable performance standards, rather than design requirements to meet what I firmly agree are worthy environmental and social goals. Perhaps the most positive application of this principal was the "bubble concept" which has been used in addressing air quality standards. In general, I subscribe to the views expressed by Charles Schultz and Allan Keense in the book, Pollution, Prices, and Public Policy.

Antitrust policies also have implications for an industrial strategy. I do not believe policymakers, even those on the Judiciary Committees of the Congress and those in the antitrust division at the Justice Department, where such policy is chiefly made, truly appreciate the effect the history of antitrust jurisprudence has had on the structure, style, and goals of American industry. In my experience antitrust policies have reduced the ability of corporations to react to changes in the structure of the domestic economy and to meet competition.

On top of the overall irrelevance of concentration policy, is simply the uncertainty of antitrust policy. When faced with uncertainty and, in this case, with the potential of litigation, American industry will not act. The growth of antitrust litigation in recent years has been staggering. Such litigation is costly and time consuming and the results are uncertain. In the two periods 1950-54 and 1970-74, antitrust litigation increased ten-fold.

Rather than incur an antitrust risk and face the unknown disposition of some future judge or jury, firms simply will not make the changes needed to react to the realities of global competition.

Antitrust was originally designed to address a self-contained domestic economy, this is no longer the case. Yet little effort has been made to look at, let alone redirect, antitrust to the modern realities. I believe that any industrial strategy must require that antitrust policy in its concentration prohibitions must be a first priority concern. A number of revisions come to mind. For example, after complete review of the recently proposed merger guidelines it may be possible to institutionalize a less restrictive merger policy.

Finally, as stated before, industrial strategy must recognize the legitimate role for government in areas not served by the market system. But such a strategy requires that policy be designed in a way that best serves and responds to changes in the economy. Unfortunately, policy in these areas of social concern have also been made with a minimum of thought as to their real implications to industry. Education policy has been notoriously slow to change. Specifically, vocational education policy and efforts to enhance the employability of those not now equipped to find and retain a job have not been well orchestrated. Our labor market adjustment policies, particularly those that address the needs of the dislocated worker (whether from technology or a plant closing) have actually been counterproductive. Our review of these policies leads us to believe that they have discouraged displaced workers from relocating.

An industrial strategy clearly involves numerous policy areas. Its goal is to increase the resources, both in terms of plant and equipment as well as

human resources available to the economy and to ensure that these resources are used efficiently for the benefit of society. In my opinion the market system, supported by policies which improve its operation, should be the central theme of any industrial strategy.

In closing, I strongly believe that the essential problem facing the implementation of an industrial strategy is the notion held by many policymakers that they, rather than the market, know best how to allocate our economic resources. In my view, the success of any industrial strategy depends in large measure on absolving policymakers of this view and convincing them that a positive approach to assuring the efficiency and adaptability of the market in the face of change is the only real chance we have of assuring the nation's continued economic growth and prosperity.

I am pleased to have had this opportunity to participate in the discussions of the concept of an industrial strategy and I will feel priveleged to respond to any questions.

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APPENDIX

A Brief Description of the Policy Project of the CED Subcommittee on Industrial Strategy and Trade

Since early last year, the CED Subcommittee on Industrial Strategy and Trade has been working to develop a series of policy recommendations in the area of industrial strategy. This report is currently slated for release later next year.

The study will cover the major components of this policy issue. Some corollary analysis and work is also being undertaken as part of a current CED study on ways to improve tne nations rate of productivity. The project is likely to rover the following general subjects:

- The Objectives and Scope of an Industrial Strategy.
- The Economic and Political Enviornment, which will include discussions of monetary, fiscal (and tax), and national security (including questions related to the defense industrial base) policies.
- The Regulatory Environment, which will include an analysis and recommendation covering antitrust and social regulatory policies.
- Facilitating Change in the Domestic Markets, which will cover labor adjustment and labor resource policies.
- Maintaining the Benefits on International Trade, which will discuss the role of domestic subsidies, changes in GATT, the issue of reciprocity, and extending trade rules to services.

- Facilitating Change in International Markets, which will discuss the role of the safeguard process, non-tariff barriers, and integrating less developed countries (LDCs) into the existing system of international trading agreements.

This study is being developed under the leadership of John Paul Lyet, former Chairman of Sperry Corporation and Chairman of the President's Export Council. Attached is a listing of the Subcommittee membership.

Subcommittee on Industrial Strategy and Trade

June 1982

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Mr. LUNDINE. Thank you very much. If it is all right with both of you, we will ask for the testimony of all of the witnesses and then have questions.

Mr. Magaziner.

STATEMENT OF IRA C. MAGAZINER, PRESIDENT, TELESIS

Mr. MAGAZINER. First I would like to try to clarify what is meant by "industrial policy," since there is a lot of misconception, I think, and there has been a lot of discussion that includes a lot of different things under the same rubric.

Personally, I do not believe there should be an elite group in Washington that wakes up every morning and decides it likes semiconductors this day and we ought to put our money there and does not like steel. I do not think there should be a group sitting in the Capital City to do that. Markets determine investment, not the centralized bureaucracy.

Second, I think it is dangerous to talk about sunset or sunrise industries, for a number of reasons. One is, whole industries do not become either high growth or decline. Certain industrial activities may become subject to low wage competition with any given industry, and certain others will not. And I think it is very dangerous to classify textiles, steel, or anything else as a sunset or sunrise industry. Some of the jobs which are clearly low-wage jobs are in the most high-technology electronics area, and some of the others in textiles are among the most skilled jobs one could talk about.

Third, I think it is a mistake to keep talking about high-tech, high-tech all of the time. In fact, if you look 10 to 15 years out, the same basic industries which dominate world trade now will still dominate world trade: Steel, automobiles, machinery, electrical machinery, and so forth. Biotechnology probably will not produce more than a handful of jobs for the next 15 years. That does not mean we should not pursue a lot of these new high-technology areas. But I think people can get carried away speaking about that.

I do not think we ought to engage in any untraditional bailouts of companies. I think what we have allowed ourselves to drift into on an ad hoc basis in this country is the worst of all possible worlds

where we put up partial protections without any moves to rationalize and make industries competitive again. The consumer ends up paying a huge cost, the government winds up a huge cost in forgone taxes, and all we do is slow down the pace of deterioration. And I think that is something we have observed in Europe for a long time, and we must get away from that kind of thinking.

That does not say that we should just let large companies go bankrupt immediately, but rather that we need some adjustment policies which can in some way assist rationalization and which can handle the human suffering associated with industrial decline.

Fourth, I do not think we need to engage in any kind of comprehensive industrial planning of an East European model. I think a lot of people associate industrial policy with that, and I think we could dismiss that as not anything which I certainly would believe in.

And finally, I do not think we are talking about any "U.S., Inc.," nor were we ever talking about a "Japan, Inc." in the way people used it. And I do not think I would advocate something like that.

I am trying to clear those things aside just as unwanted distortions. Let me try to turn more positively and say what I think we do need.

First of all, I think the current policies we have—and I will not spend too long on this really—are misleading to the public. They came in being called "supply-side policies" which were intended to increase the level of investment and let the market work with respect to the pattern of that investment. But, in fact, those policies were fluid from the beginning. They are not really supply-side policies, nor can you have successful policies that are only supply-side or only demand-side.

What I think we have to realize is that a stimulation of long-term wealth creation requires the correct patterning of investment as well as the stimulation of the level of investment. You will not have a patterning of investment that is going to promote long-term wealth creation unless you have sufficient demand. No businessman will invest over the long term unless he sees market growth coming. He will invest in productivity improvements which might make his business leaner, but it does not improve the economy as a whole.

What I think we must realize is we can believe in a market system, which I do, and believe that private actors should determine investment decisions primarily, which I do, and recognize that there are certain imperfections in that market which cannot be overlooked and which Government policy must address. I would like to briefly summarize some of those imperfections. And I think it is the nature of these imperfections which determine the failure of the Reagan policy.

I think the Reagan policy has a lot of confusing macroeconomics and has mishandled cyclical problems. I will not get into those today. But even if we put those aside, I think it has serious problems in terms of long-term wealth creation. And that has to do with these kinds of market mechanisms.

There are three kinds of imperfections I would point out. One is cases where the public and private return on investment are inherently different. Second are cases where market mechanisms work,

but work slowly. And third are cases of what I would call structural adjustment. Let me briefly outline each of these.

It has been well documented in cases of research and development that people funding the research and development very often do not receive the full benefit for their funding and that therefore very often an insufficient amount of R&D, specifically long-term R&D, will take place purely from the private participant himself—and from a public point of view, greater R&D is a value—than will necessarily happen by market mechanisms in the individual firms.

Second, especially in an uncertain world, as today, if I am an American businessman trying to decide where to expand my company, instead of going into a manufacturing business where I will be competing with very active Japanese and German competitors, it might seem easier for me to go into a business that is a nontrading business, a warehousing business or a business distributing Japanese products rather trying to go in and manufacture and compete with them, or maybe even just be a cash manager for a while because the times are uncertain.

From a private business point of view, I as a business consultant might advise my client to do that. But from a national point of view, if you have most of your major manufacturing companies, or many of them, putting all of their money into resource industries or nontrading businesses like finance companies, cable television, or whatever, then you will have a suboptimal pattern of investment nationally.

Third, with respect to infant industries, very often if you start out behind in a competitive battle where your other national competitors are ahead of you, it will be very risky for you to try to show a good return on investment by trying to catch up with them. The Japanese faced that problem in the 1950's when they were thinking about their steel industry and the auto industry and realized from the private point of view, private investors would not put money in the Japanese steel industry in the early 1950's. They were too far behind and could not get a good return on the investment.

If you wanted to put your money in steel in the early 1950's, you would have put it in the U.S. industry. But as a national government, you cannot accept that answer. If a whole series of your industries have fallen behind or if you have fallen behind in the technology areas.

Fourth are areas which you might call linkage industries. If I am an investor in the automobile industry specifically, I care only about my automobile company, and it may very well be prudent for me to say, this company is going under and let us just pull out.

On the other hand, from a national point of view, if 30 percent of machine tool capacity is tied up in the automobile industry, then it can be a serious problem to pull out of the automobile industry. There are linkages that certain industries have throughout the economy which become national problems and not problems for just the private investor in that specific company.

Conversely, the Europeans, when they look at the Airbus and say, we will not get a good return on investment in the Airbus aircraft, said the real return to European industry will be in all of the feeder industries that feed that and the development of all of the

high-technology machine industries that will develop in developing a successful aircraft industry.

So I think you have to look at these linkages in the economy which will not automatically happen considering private return on investments only.

Finally, in terms of cost strategies, it is often simpler and easier for a manager of a firm when he has to reduce his cost to be competitive to think simply about wage decreases. Conceptually, that is much easier than thinking about what you have to do to gain a competitive productivity advantage. You may very well move to chase cheap labor in developing countries, or you may move to invest a lot of money to fight your union to lower wages and so on and so forth. And that may or may not be an appropriate role of business.

But I think the problem comes that from the public point of view, it is productivity improvement that spurs wealth creation. It is growth that spurs wealth creation and not hammering wages.

In terms of slow market development, I have talked about differences between public and private OY. There are some cases where market will work, but it will work slowly. You have to remember that a competitive position in the business is like a leading position in a race. If you are competitively ahead of other people in other countries, you cannot just stand still, you have got to keep moving ahead. And therefore, if the market mechanisms function too slowly, you can wind up losing your competitive lead.

So, for example, we have a situation where many companies, because of the uncertain economic times, are what you might call risk-aversive, taking long-time risks in investments, but it has a real impact.

If I am afraid to try to fundamentally alter my production process or go into a whole new product area because the payback is in the 6 or 7 or 8 years' range, but my foreign competitors are getting some government assistance to be able to take the longer term risk, then I will suffer competitively.

Also, in terms of small and medium size firms, they often will not have the ability to take advantage of opportunities with respect to export. Eventually, they will, but maybe too slowly. Skill development is another area where you have labor shifts that have to take place and skill training that has to take place. That will eventually take place in a market system, but if it takes much longer than it does for your competitors, you will suffer for it.

If competitive countries have programs for skill training and labor market policies, trying to anticipate skill shortages and needs and so forth, they can gain a competitive edge.

The third area besides public-versus-private RY and slow market mechanisms where the market sometimes fails is in structural adjustments. In a healthy free-enterprise economy you will have necessary changes in the industrial structure. In fact, that is part of what propels standard-of-living improvment. Certain factories will become uncompetitive. New factories will have to open up. Certain processes improve, calling for layoff of certain workers. Certain new products are invented, some products become outmoded.

The important thing is to minimize the human suffering associated with that, both for workers and also for regions, and to, in a

sense, promote a situation where people know they will not suffer for these normal dislocations. What we do in this country now is we do not have any positive adjustment policy. So what we do instead is go into some partial protection, or we fight battles to try to keep uncompetitive processes alive rather than realizing that these processes should turn over and there should be industrial restructuring.

But people who bear no fault in this happening are suffering for it. Other countries have gone further. And there is a final justification for some kind of industrial policy or patterning policy is simply that we live in a competitive international world and most of our major trading partners are engaging in these policies.

And one thing that concerns me very much as an international business consultant working for a lot of firms abroad as well as firms in the United States is when I look at a lot of key industries we have worked in over the past 5 years you can see very aggressive investments going on in a lot of areas in France and Germany and Japan, particularly, and our U.S. clients are just being much more cautious and not doing that kind of investment.

And what worries me is we can look at the problems we have in steel, consumer electronics, and autos, and those are pretty well documented. But if we look at where our current positive trade balance is besides agricultural products—that is, if you look at the machineries industries, the electronics industries, the aircraft industries—the kinds of investment patterns I see taking place in other countries from companies assisted by their governments leaves me a great deal of concern about the next 5 or 10 years.

I think the kind of declines we will see in a lot of those industries are going to be just as great as what we have seen in the past unless we reverse our policies.

I have probably used most of my time, but let me get into a couple of very specific proposals I would make. I would say that in making these proposals that what I am talking about here is simply to correct market imperfections. I think the private market ought to function as the primary mediator of investment decisions in the country. But what I am looking toward is taking these market imperfections I talked about, which I think are hurting our economy, and trying to adjust to correct for those market imperfections.

For one thing, I think we need some kind of applied research and development fund to deal with the patterning of investment. People are pointing at the level of private R&D as up in this country in the recent year and a half. But I think that is misleading. I think I can answer why in the question-and-answer period.

Second, I think we need some kind of a high-risk reimbursable loan fund. We have seen these work in some other countries where you will have some Federal funds to match investment decisions initiated by companies who have a longer term payback to try to encourage a slightly higher risk profile in the kinds of investments taking place.

Third, I think we need something to consolidate the kind of export incentive system we have right now. Right now I think we are wasting a huge amount of money with the DISC, and I think

we have no consolidated policy for export incentives that makes sense.

Fourth, I think we need something targeted toward small and medium-sized businesses in traded business areas. We do not distinguish among different small businesses right now. Some of them are wholly regional and nontraded businesses where the investment would take place anyway regardless of any help from the Federal Government. Some are purely serving larger companies or are like feeder companies to larger companies where the investment is primarily determined by the larger companies.

But some of them are trying to develop international businesses and businesses that trade. And we really have very little that addresses that problem right now. Most of the SBA work, I think about 90 percent of it, goes to small nontraded firms, and mostly nonmanufacturing.

Fifth, I think we need something to deal with the capital goods industries. What has been successful in a few other countries is to have a system of incentives for companies to purchase new prototype capital goods. That has a double effect. One is that it helps companies remain competitive in their productivity because they are replenishing their capital stock and buying new prototype equipment as it becomes available more quickly. And second, it helps the capital goods firms by doing what the Defense Department might have done for the aircraft industry, which is to provide an initial market or an incentive for marketing new prototype products when they are at the high part of their cost curves.

Next, I think we need some kind of industrial policy board which will have the function of trying to enter into a healthy analysis and dialog with industry about the movement of the economy, and will kind of be the one that looks out for the public return on investment in industry.

I do not think it should be a board that is centralized and allocates investments, but I think it should be a board that does an analysis function of industry. I think the board proposed in the bill before this committee is a bit too large for my taste. I think it might become unwieldy. But I think something along those lines would be very useful.

Next, I think we need some kind of regional programs which will take areas with some percentage of unemployment over the average and target it to maybe specific SMSA's or specific areas within States and try to produce incentives that will encourage industry to locate in those areas. Right now we have a competition among the States for industry where every State is going out with its own marketing programs and so on, its own tax incentives. And I think the urban enterprise zone type of legislation will really not influence people very much. I do not think it is sufficient incentive for companies to really make investments.

I think we must do something for places hard impacted. The danger I see is that through political logrolling, every region will be designated. We have seen that happen in the past. I do not know whether we can resist it or not. But I think something like that has worked in some other countries and could be useful.

Finally, I do think that we need some kind of enhanced labor market programs for retraining. Just to finish, let me say a couple

of things about the characteristics of these things. I think you can run a program like this for about 10 percent of what the Reagan tax cut gave back to industry. So I think we are talking about a program that does not have to be very expensive.

Second, I think you could run a program like this in a decentralized way, and I think you have to run it in a way with the investment initiatives come from industry. I do not think the Government should be the one initiating investment decisions except where the Government is a purchaser. I think the Government should be responding to investment decisions on the plate in industry to try to help the patterning of that.

I think there are risks associated with this kind of program. I would be naive to say not. You have the risk of favoritism or corruption when money is being given out, a risk of waste, a risk of political pressure groups will vie for the public purse and create a bad patterning effect. But overall, I think the risks of doing nothing are much greater, and we should move in this direction.

[The prepared statement of Mr. Magaziner follows:]

NEW POLICIES FOR WEALTH CREATION
IN THE U.S.
TESTIMONY PREPARED BY
IRA C. MAGAZINER
PRESIDENT OF TELESIS, INC.
TO THE SUBCOMMITTEE ON ECONOMIC
STABILIZATION OF THE COMMITTEE
ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
SEPTEMBER 22, 1982

Mr. Chairman and members of the committee, I appreciate this opportunity to present my views on the need for a new economic development policy in this country.

PERSONAL BACKGROUND

For the past nine years I have worked as a business strategy consultant at Telesis and The Boston Consulting Group, advising corporations on how to utilize their resources to become more competitive and to grow. I have worked for companies in a wide variety of industries based in the U.S., Japan, Germany, France, Great Britain, Sweden, Australia, Canada and Mexico.

For the past six years, I have also consulted for governments and coalitions of industry associations, unions and financial institutions on questions of national economic development and industrial policy. Telesis, with offices in Providence, Paris and Melbourne, was founded three years ago in large part to develop new conceptual approaches for such policy-making. Our efforts have focused on using business strategy concepts and knowledge about international competition to create economic development studies in Sweden, France, Great Britain, the Republic of Ireland, Belgium and Japan.

In addition to my consulting work, I have coauthored two books, one on Japanese industrial policy and a recent one on the need for new directions in U.S. economic policy. Studies that Telesis has performed in Sweden, France and Ireland have also been published in book form in those countries.

WEALTH CREATION

Our economic discussions since World War II have focused on the use of demand management to moderate the business cycle. Inflation and unemployment caused by investment cycles have been perceived as our major economic problems.

Today, we have come to the realization, however, that our problems run deeper than simply managing aggregate demand. Our basic ability to create wealth is in question. It is, therefore, necessary to take a more fundamental look at the process of wealth creation and examine where we are failing.

Wealth is created by productivity improvements and the economy's ability to employ human resources fully. Together, steady productivity improvements and full employment lead to a growth in goods produced in the society.

The driving forces behind productivity improvements are the development of more efficient production processes, investment of sufficient resources to implement them, and an effective organization of the workplace to optimize the teamwork of the workforce. Productivity improvements must be seen in a competitive context. If foreign competitors improve productivity faster than U.S. companies, than productivity improvements may not increase wealth.

Maintaining full employment in today's dynamic world economy requires a commitment to developing both new products and new markets for existing products. The development of new improved products stimulates replacement of goods, increasing demand. New market development for existing products requires taking steps to encourage the development of the poorer economies which now house most of the world's people.

Certain industries require less industrial skill and

less complex industrial organization to be successful. Production of these goods must shift away from industrially developed countries to stimulate economic development in the poorer nations. In this way, citizens of these countries will be capable of participating more fully in the world economy both as producers and consumers. The less sophisticated goods which poorer nations can produce can be traded to more industrially developed countries for capital goods and more complex consumer goods.

Long term, the living standard in an industrially developed nation is improved through the process described in Exhibit 1. Investment is the primary mover in wealth creation. The level of investment is important, but the pattern or allocation of investment resources is even more important. As the chart demonstrates, wealth creation requires both stimulation of supply side efficiencies and of demand. When supply side stimulation takes the form of direct enhancement of productivity, industrial restructuring, new product development and new market penetration, then these goals can be compatible. Productivity improvements, new product development, restructuring to higher value added industrial activities and new market development ensure a competitive supply of U.S. goods while the resulting lower real prices, higher real wages, growth from new overseas markets and growth from new product substitution fuel demand.

While the U.S. economy remains strong in many ways, over the last decade we have not succeeded in pursuing these goals of wealth creation. Our rate of productivity improvement has been among the lowest of industrialized countries, our unemployment rate has been among the highest, our trade balance has remained significantly negative, and our ability to pay for increased oil imports with manufactured goods exports has lagged that of other industrialized countries.

CURRENT ECONOMIC POLICIES

Post-war policies of demand management have assumed that the process of wealth creation will occur if variations of the business cycle are properly managed: new product and process developments will take place; new markets will open; the necessary capital and labor adjustments will occur as industries restructure; and U.S. goods will be competitive in world markets.

Current supply side solutions rest on false assumptions about demand stimulation and focus only on overall levels of investment in the economy not on patterning of investment.

The assumptions inherent in the Reagan economic policies are (1) that private industrial investment can be boosted simply by reducing government's role in the economy, and (2) that this increased investment will cause America to become more productive and competitive. These assumptions have led to policies which have cut taxes primarily for wealthy individuals and companies in order to increase funds available to industry; reduced enforcement of environmental, worker safety and trade regulations to allow industry a freer hand with its funds; maintained high interest rates to dampen demand in order to reduce inflation and raise business confidence; and reduced government social spending in the hope that eliminating these expenditures would not only increase work incentives, but also minimize budget deficits in the face of increased defense spending.

This program has proved contradictory on its face. Tax cuts combined with increased defense spending have increased the budget deficits despite cuts in social programs. High interest rates have prolonged and deepened the recession, making businesses unwilling to increase investment. The recession has increased unemployment and generated a need for increased

social spending even as further attempts to reduce social programs are being proposed. The tax cuts, even though they primarily benefit wealthy individuals who have a higher propensity to save, have not yet resulted in either greater savings or greater investment.

Critics of the administration's economic policies have understandably focused today's economic debate on these contradictions. But the problems with current economic policies go far deeper. When supply side programs are closely examined, we can see that they embody some very careless and dangerous assumptions about the process of wealth creation.

When we look to the economic performance of our major trading partners, we see that government cannot really be the source of our competitive decline. The U.S. already has a smaller government sector and lower public levels of social expenditure than almost all other industrialized countries. Government regulation of labor markets is more stringent in other coutnries, while worker safety and pollution requirements are generally comparable to our standards. In short, government can and must be made more efficient, but government social programs and regulations are not the cause of our declining productive growth and competitiveness.

Nor will simply placing more funds into private hands necessarily result in an acceleration of product and process development or greater competitiveness. Most of these funds will not be invested at all, but will be used for consumption. Estimates are that less than 30% of the personal tax cuts will actually be saved and invested. Of the additional funds which are invested by individuals and companies, a large proportion will go into non-productive uses - such as financing mergers and acquisitions, speculation in real estate or commodities,

or fees for lawyers, accountants and investment advisors who earn handsome incomes from engineering these investments.

If recent history is any example, even a large proportion of those funds which do flow to productive industry will not be used in ways which ensure long term competitiveness. Insufficient funds will go into competitively important investments: long term research and development projects, projects which fundamentally improve production or product technology, overseas market development, or high risk longer payback capital investment projects. Insufficient investment will go to retrain our workforce for higher skilled jobs required by many growing industries or to ease the hardship of regions and workers dislocated by necessary industrial restructuring. Not enough money will be used to modernize traditional industries such as the auto and steel industries, which cannot be neglected because of their crucial role as stimulants to other parts of the economy. There will be no inducements to ensure that our most successful export industries - those making electrical and mechanical machinery - will be able to develop new competitive products.

Because of the kind of incentives provided by our present business system and the depressed environment created by current economic policies, many U.S. manufacturers will find it more attractive to invest their additional funds in warehouses and distribution systems for importing Japanese or European goods rather than investing in manufacturing facilities to compete against these goods. Others will find it useful to make incremental "maintenance" investments to improve costs marginally instead of taking more fundamental investments to improve their competitive position. Many firms will find it attractive to chase cheap labor and use tax refunds indirectly to set up

plants abroad rather than to put modern facilities in the U.S. Still others will become cash managers using their funds to earn returns on trading and money lending rather than on manufacturing investments. While these uses of tax-cut dollars may maximize the short term cash flow of the investing companies, they do little to enhance the long term growth, productivity and competitiveness of the American economy.

It has been fashionable in recent years to blame the government for the decline of U.S. business competitiveness and therefore the decline of the U.S. economy. These arguments contend that inconsistent and burdensome government regulation of safety, the environment and antitrust combined with excessive taxes and high inflation inducing deficits have shackled our companies making them unable to compete.

While undoubtedly government policies have at times been misguided and government efficiency must be improved, it is a wild exaggeration only to blame government policy for competitive declines in the U.S. steel, auto, consumer electronics and other major industries. Private industrial companies and financial institutions primarily determine the strength or weakness of our economy by the investment decisions they make. The government plays an important role in guiding the business system to operate in the national interest and in providing a healthy environment for business investment, but government alone cannot be blamed for our economic difficulties.

In the book I coauthored, Minding America's Business, management inadequacies which have been a primary cause of our economic decline are detailed. But, failings of business management do not mean that government direction should replace market forces in the allocation of capital in this country. Strategic errors by businessmen are a partial cause of our problems. But even if these errors were not made, the problem of our suboptimal pattern of investment would remain. Rather than seeking to place blame on either government or business management

it is more useful to examine the business system itself and find the structural inefficiencies which must be fixed in order to support economic growth.

MARKET IMPERFECTIONS

The main cause of our investment patterning problems lies in certain market imperfections brought about by the complexity of today's international competitive marketplace and by the need to maintain certain basic standards of social decency in the organization of our society. Because of the first factor, public and private investment returns can differ for many projects and market mechanisms may react too slowly to changing events; and because of the second factor, the needed structural adjustments in labor markets may not occur due to the human costs associated with them. It is for these reasons that a more active government role is required to assure economic development.

The basic inadequacy of today's "supply side" solutions is that they do not in fact enhance the productivity and growth of the U.S. economy. The short term recessionary effects slow investment. The assumptions about how to revitalize American industry rest on improper diagnoses of the problems. Oppressive government regulation can be an annoyance to business, but is not a fundamental cause of competitive decline. Reducing this regulation will have little effect on the ability of our business to compete in world markets. Increasing levels of investment can be helpful, but only if the pattern of use of that investment is appropriate. Current policies "throw" a huge amount of money in the direction of wealthy individuals and companies, but they do nothing to ensure that these funds will be used to improve U.S. productivity. In fact, only a small fraction of these funds will be committed to improve

the competitiveness of our economy.

While the aggregate shortcomings of today's economic policies can be solved through the proper balance of monetary and fiscal policy, the problems caused by an inappropriate patterning of investment require a new set of policy tools. Since this shortcoming rests on the existence of market imperfections, it is useful to identify more specifically the nature of these imperfections.

Public vs. Private Return on Investment

The sum total of private return on investment (ROI) decisions may not result in the optimal public return on investment if market forces alone dictate investment choices.

Research and Development - often yields benefits beyond those which can accrue to the individual investor and innovator. The public returns to such activities can therefore be greater than those realizable by the investor. Without government intervention insufficient R&D investment may therefore be undertaken by private investors.

Given today's difficult international competitive environment, it may make good business sense for American manufacturers to concentrate investments in nontraded businesses or resource businesses where they do not have to meet tough Japanese and German competitors. Rather than competing in internationally traded manufacturing businesses, many U.S. manufacturers have been earning high returns from investments in finance and credit operations, distribution companies, local communications ventures, and nontraded manufacturing ventures. This strategy may make sense for these companies, but it can lead to a gradual erosion of the manufacturing base of the United States.

In many infant industries where U.S. companies are late to enter a market, it may well be that private investors are better off investing in the foreign "leaders" who are competing with U.S. producers, rather than investing in fledgling U.S. companies. Similarly, if one had looked to invest in steel in the early 1950's, the strong U.S. competitors with 70% of the world market would have looked like a better investment than the fledgling Japanese industry. But governments cannot view this investment decision in the same light as private investors; they must take a longer time horizon.

Thus, the Japanese government had to take the view that developing that infant industry in Japan would yield a good future ROI even though prudent private investors would not make the same calculation. A similar view may need to be taken in cases where U.S. industry has fallen behind in new product technologies (such as video cassette recorders) and shows no sign of undertaking the aggressive investments needed to compete with foreign firms.

Certain industries have linkages which mean that their success has enormous significance for the success of many other industries in the country. For example, the U.S. automobile and aircraft industries use a significant portion of the output of the U.S. steel, rubber, aluminum, plastic, machine tool, metalworking and other industries. Investors in a given automobile company need not consider these inter-relationships in making a decision about expansion, contraction, or liquidation. However, government officials, in calculating a national ROI, must include these considerations. Key "feeder" industries, such as steel, electronic components, and mini computers also exhibit these crucial linkages because they provide critical components to many other industries.

A final area where public and private ROIs might differ is in decisions about how to reduce costs in production. For a private investor, reducing wages by locating in a low wage country may be an easier way to cut costs than investing in new product design or new processes to improve productivity. In many cases, the public ROI might dictate the opposite choice.

Slow Market Mechanisms

In cases just described, the public and private ROIs might differ. As a result, market mechanisms alone are not sufficient to ensure an optimum pattern of investment from a

national point of view. In other cases, markets will adjust to changes in competitive conditions, but the adjustment process will be too slow. Because of the delay, competitive advantage can be lost. Competitive advantage in a business is similar to a leading position in a race. A company which aggressively commits resources to build market share by pushing product and process innovations, establishing strong distribution networks, or pricing aggressively may be able to establish a significant leadership position which can become unassailable. The private marketplace in the U.S. may signal the appropriate decisions on new investments, but sometimes these investments are not undertaken with the same speed as foreign competitors. This delay in reacting may put U.S. companies at a competitive disadvantage when compared to foreign rivals whose governments and banking systems are geared to assist more aggressive behavior.

Many managers in large established companies are reluctant to take too high a risk profile in their investments. Gradual changes in technology or capital stock are usually safer. Yet, in many cases, it requires innovative approaches and significant risk-taking to gain long term competitive advantage in new business areas: building a competitive advantage often requires a business manager to pioneer approaches which radically rethink the way in which a business is conducted.

Medium and small size firms, which can sometimes be more flexible and take these risks, often find it difficult to acquire the capital required to make these competitive moves fast enough. Venture capital exists, but a firm may not be able to arrange financing in time to capitalize on its innovation. Equally important, a firm may not have access to a quantity of funds sufficient for the long period of investment

and negative cash flow required to pioneer a new product and bring it to successful maturity. Venture capitalists in this country often require too quick a payback, and in many cases they do not have the resources to continue to fund true successes as they grow. We have many successful small new technology company startups but only a small number of long term success stories. And many of these successful firms are significantly aided not by the private market but rather by funds provided by government, usually the Defense Department or NASA.

The development of appropriate skills in the labor force also can occur too slowly for market opportunities to be realized. We often find ourselves in the position of simultaneously having significant unemployment and shortages of necessary skilled workers in certain industries. Small and medium sized companies, in particular, lack the resources to conduct the training required by new business opportunities.

There is a final reason why market mechanisms often move too slowly: the pace of technology and the scale of optimum investment have increased dramatically in many industries. Companies have found in many industries that new generations of technology are more expensive to enter and have a shorter life span during which their investment must be recouped than in the past. Also, in many industries, the size of plant required to achieve optimum costs has also increased rapidly: new capital investments are large when compared to existing assets and current market shares. This factor has increased the risks confronted by the firm both absolutely and in relation to existing resources, and has therefore slowed the investment process in many industries.

Problems of Structural Adjustment

Besides these market imperfections, there also exist

social problems which must be addressed as economic progress is pursued. Industrial restructuring is a natural part of a healthy economy. New products are discovered and others become outmoded; productivity improvements reduce employment in some factories and increase employment in others; some industries migrate to low wage countries while technological breakthroughs create new industries in high wage countries; some skills become obsolete and new ones are needed.

Many of the competitive declines we have suffered in basic industries such as automobiles and steel have led to serious social dislocations. These dislocations can and should be remedied by aggressive investments to re-establish the competitive position of U.S. firms in these industries. However, in these and other industries, some adjustments by workers and regions are unavoidable, and they occur simply as a natural result of growth and of the evolution of our industrial structure.

Although current events may suggest otherwise, we have in the past shared a bipartisan commitment to eliminate the human degradation associated with massive unemployment in depressions and the specter of malnutrition and illiteracy associated with generations of inherited poverty. Similarly, we have generally found it unacceptable to allow workers and regions, who through no fault of their own, are forced to shoulder a disproportionate share of the burden of industrial restructuring, to go without government assistance. Unfortunately, while we have had some small regional assistance and worker retraining programs to alleviate this social cost, these have been inefficient and underfunded. Our major means of easing this burden has been to resort to protectionist measures which prevent industrial restructuring and retard our economic progress. The cruel hoax associated with such

measures is not only that they often retard economic progress, but also that they do not prevent the loss of jobs and the decline of regions in the long run -- they merely prolong the process. Temporary protection when accompanied by policies to develop the ailing industry may in some cases be appropriate - but by themselves are often harmful and futile.

Allowing the marketplace simply to eliminate jobs and bankrupt regions is not appropriate in a civilized society. Costly protectionist measures are not economically healthy either. For these reasons, a more active government role to ease these social dislocations, while promoting economic progress, is essential to increasing our living standards.

THE NEED FOR NEW POLICIES

These market imperfections and the social costs inherent in industrial restructuring create the need for new policies which leave intact our market economy, but which superimpose a set of government and industry programs to address these imperfections and social problems. These policies must improve the pattern of our industrial investment, as well as increase the level of productive investment. Such policies will be both more efficient in using resources and more effective in gaining results than current "supply side" policies.

Our more successful trading partners in Japan, Germany and France are engaged in a series of joint industry-government projects to overcome market imperfections which hinder competitive performance. Each country is implementing targeted programs to ensure sufficient funds for industry-initiated research and development, high risk large scale projects, and major process innovations. These countries are also committed to joint management-government-union industrial policies to ease necessary industrial dislocations through both active labor retraining programs and regional policies which provide

substantial incentives for industry to assist workers and communities.

These nations have all created specific bodies whose aim is to spur industrial development. They have created tax incentives for savings and investment, and these tax incentives are structured to coincide with existing banking relationships to ensure that funds are put to productive industrial use. Business and government leaders in other countries have realized that such positive industrial policies are a far less wasteful and more certain means of stimulating long term productive growth than macroeconomic "trickle down" approaches. The lesson they have learned is similar to one we should have learned from our social and military ventures of the late 1960's -- desired goals cannot be reached simply by indiscriminately throwing money at problems.

The corporate and government consulting assignments of Telesis during the past few years have deeply immersed us in the international competitive development of over a dozen important industries including the machine tool, consumer electronics, automotive, specialty chemical, electronic component and mechanical component industries. The concern I have for the U.S. economy comes from seeing the concurrent conservative investment strategies of the U.S. companies in these industries and the aggressive postures of key European and Japanese competitors. My concern is heightened by the role being taken by foreign governments to assist their companies when compared with the passive role played by the U.S. government. U.S. competitors are further disadvantaged by the negative effects of the current recessionary policies of the Reagan Administration.

Foreign industrial policies have not always been successful, but to point to British "lemon socialism" or the

French "Plan Calcul" or Concorde and use these failures to discount foreign experiences is both naive and dangerous. Foreign companies and governments have learned from their mistakes and have become more sophisticated in the conduct of their industrial policies. They will undoubtedly continue to make some mistakes, but they will also enjoy many successes. If market imperfections and social dislocations provide the theoretical justifications for industrial development policies, the aggressive actions of our major competitors create the pragmatic imperative to move ahead forthrightly.

THE ALTERNATIVE TO CURRENT ECONOMIC POLICIES

Until recently, the U.S. debate on industrial policy has tended to be highly ideological with a heady dose of posturing on all sides. We hear about the gleaming virtues of the market system, or the insatiable greediness of industry, or the bumbling incompetence of government bureaucrats. Carried on in these terms, the debate has presented two polar options for economic development policy: (1) having the government select areas for investment and engage in comprehensive national planning (picking winners) or, (2) getting the government to reduce further its role in the economy through less regulation, lower taxes and reduced government spending so that the private sector can get on with the job of revitalizing the economy (supply side). While rhetorically appealing, this extreme characterization of the alternative policies jeopardizes the debate from the start. Pragmatic approaches to the problems of economic growth cannot emerge from this type of discussion.

Before describing the substance that new policies could take, it is necessary to make a number of statements about what such policies should not be:

- The U.S. should not set up economic policies whereby politicians or a bureaucratic elite will sit in Washington and pick winning industrial sectors to support with federal funds.
- Public money should not be used to bail out dying companies nor even to assist companies near bankruptcy unless specific circumstances dictate that these firms can be restructured for long-run competitive success and specific steps are undertaken to make such government participation shortlived.
- The U.S. should not engage either in comprehensive economic planning characteristic of the centrally planned economies or in indicative planning which was tried in earlier periods in some western countries.
- The U.S. economy should not be seen as a "U.S., Inc." with a government investment committee which acts like the finance committee of a major corporation; markets should dictate investment initiatives, not the government.

The role of government should not be to select specific industrial sectors for investment, (vertical policies) but rather to take the public point of view in assuring that incentives are given to certain general categories of investment, (horizontal policies) such as those in:

- traded manufacturing industries
- basic and applied research and development
- high risk projects
- skill development
- the application and diffusion of new technologies
- new capital goods technology

- maintaining the competitive position of key linkage industries
- overseas market development
- the necessary infrastructure for human capital development, i.e. training and education
- the maintenance of physical infrastructure, i.e., ports, rail, water and sewage systems, etc.

The government should also play a role to assure that social dislocations are minimized as a result of industrial restructuring through programs to provide meaningful incentives for companies to:

- locate in regions hard hit by unemployment
- engage in active worker retraining programs
- provide greater employment security in exchange for more flexible work rules.

Some examples of the types of programs which might accomplish these goals are:

1. The establishment of a grant fund for enhanced applied research and development. The fund would give aid to specific projects devised by companies for research and development with commercial potential. Ideas for projects would come from industry, and companies would be expected to put up at least 50% of the funding. Proposals would be judged by panels of experts drawn from industry and academia as well as government. After a certain lead time, results would be made public to other U.S. manufacturers: joint projects among companies, universities, and research institutions would be encouraged.

   Other countries, (Germany, Japan, France) are moving

ahead of the U.S. in commercial research and development. U.S. projects are heavily weighted to defense applications. These military projects have some spillover to commercial markets, but they are often too specialized to have wide commercial applications.

2. The establishment of a conditionally reimbursable loan fund to support high risk investment projects. These projects would be those whose payback is beyond three to five years and whose character is such as to alter the fundamental product or process technology in a business. To ensure an appropriate allocation of risk, the fund would make loans equal to or less than company equity participation in the venture. These loans would be repayable according to a schedule based on the commercial success of the project. If the project fails, the loan is not repaid; if the project succeeds, then repayment would be made at market interest rates or with an equity rate of return.

   One fundamental problem with U.S. industry is a fear of making investments with long time horizons. This type of fund has performed well in France and Sweden to encourage investments with longer time horizons.

3. The establishment of a program for small and medium-sized manufacturing industries which will assist them to expand their domestic production and distribution systems and to explore international markets for their products. This program would be built around several regional offices which would assist small and medium sized firms through education,

assistance with making contacts, consulting, and financing (low interest loans or loan guarantees) for projects.

Too few small and medium sized U.S. manufacturing firms have or can attract the financial resources which are necessary to expand both domestically and abroad. A number of other countries, such as Germany and France, have programs to provide such assistance. The Small Business Administration does not have the competence nor the organizational focus to fulfill these needs adequately. Most of its activities involve distribution companies, or nontraded manufacturing operations, rather than engineering or manufacturing firms in internationally traded businesses.

4. Establishment of an overseas marketing board to assist U.S. companies to establish distribution abroad by issuance of insurance and loan guarantees at reasonable rates. The U.S. already has a series of organizations and programs designed to increase exports, but these programs are uncoordinated and underutilized by American business. The U.S. needs to coordinate its export promotion programs and focus the programs to encourage the type of investments that will improve the competitive strength of these businesses. Germany, France, United Kingdom, and Japan already have more aggressive programs to coordinate export policy. Foreign experience has shown that these organizations can be particularly useful in encouraging market development in third world countries.

5. A low interest financing program to encourage

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companies to buy new capital goods prototypes from U.S. producers. This mechanism would encourage U.S. industry to modernize their capital equipment while at the same time assisting U.S. capital goods companies by providing initial markets for newly developed products. The Japanese have successfully used these types of financing measures to encourage innovation in capital equipment. Such measures would be particularly important for the U.S., since so much of our remaining competitive strength is in electrical, electronic and mechanical capital goods businesses, and it is precisely these markets which will be under most severe international competitive pressure in the coming years.

6. The establishment of an advisory body on industrial policy to consider from the point of view of the public R.O.I. the competitive evolution of the U.S. industry base. The Board recommended in H.R. 6099 is one possible incarnation of this suggestion. In principle the Board would have functions such as the following:
   . Monitor the international development of industries with extensive linkages in the economy and provide external commentary for Congress and the executive branch on problems and opportunities in these industries. Almost all other governments are monitoring industries such as steel, automobiles, computers, semi-conductors and telecommunications and it would be wise for us to do so as well. We now perform these analyses on an ad hoc basis through reports done by various government agencies. The existence of this monitoring capability would not imply active interventions, only

healthy dialogue with the industries.

- Monitor developments in the international economy which might lead to future competitive difficulty for particular industries. This activity could help anticipate future industrial trouble spots by monitoring industrial developments in low wage countries. Such efforts at anticipating long term industrial evolution will not necessarily provide accurate predictions of the future, but developing these forecasts will force government and industry to think strategically about the development of U.S. industries within the international economy. The Japanese long term vision and the French plan serve this goal well.
- Identify and analyze the effects of the current multitude of programs now existing within the government to protect, to subsidize or to provide selective assistance to industry. This vast array of programs ranges from defense procurement to selective tax expenditures in agriculture, housing, and industry.

7. A program to offer capital grants and training grants for companies to locate in areas which have unemployment levels greater than some percentage over the national average. The Reagan Administration has abolished the regional commissions which had been a part of the Department of Commerce. Although well-intentioned, these commissions had not performed well in encouraging economic development: they were underfunded and not designed to encourage critical private investment. Every other industrialized country has a comprehensive program of regional

disparities in income and employment that comes with industrial development. Simple tax incentives and regulatory relief, as proposed by the administration's proposal for enterprise zones, will not be sufficient to do the job.

8. A comprehensive federal plan to assist workers who face losing their jobs due to necessary industrial restructuring. This labor market policy could include some of the following features:

   . Financial compensation to affected employees which is funded by contributions from both companies and government for a set period of time.

   . Specific retraining programs or voucher programs to encourage firms to train people laid off due to plant closures.

   . Tax incentives for companies to remain in existing communities.

   . Provision for federal unemployment payments to be made through companies so that individuals may remain at work or in training courses in cases of economic downturns.

   All other industrialized countries have measures such as these to varying degrees. Even in Great Britain, displaced workers are often given "golden handshakes" of one or in some cases two year's full pay by the company when laid off permanently.

THE CHARACTERISTICS OF THIS EFFORT

At first glance, it appears that efforts to develop an effective development policy in this country will result in a bureaucratic maze of boards, agencies and banks which will

wreak havoc on the economy by carelessly doling out billions of dollars of federal funds. In fact, an explicit development policy would be more cost effective than the current policies of the Reagan Administration. Indiscriminate tax expenditures which total over $400 billion over the coming years could be replaced by more targeted expenditures. Targeted expenditures would most certainly yield better results for a far smaller federal expenditure. If the Reagan tax cuts for private citizens with income in excess of $40,000 per year were rescinded, more than enough funds could be made available for an active policy to overcome these market imperfections and the budget deficit could still be cut dramatically. In addition, if the following principles are followed, the spawning of a new large bureaucracy can be avoided.

Decentralization

One of the appropriate allegations often leveled against advocates of industrial policy is that they envision a centralized elite doling out investment funds. Creating one central board or bank to preside over industrial redevelopment runs this risk. Maintaining a few distinct agencies each charged with separate, but coordinated responsibilities will allow a series of actors to be responsive to requests from industries for assistance.

Few Permanent Staff

The most effective industrial policy agencies around the world are those with small permanent staffs. These staffs use experts from industry, universities, business professions, unions and the financial community on boards to evaluate projects and allocate resources.

Investment Initiatives Must be From Industry

Initiatives for investment projects and the great

majority of investment funds for a project must come from the industries themselves. In a market economy such as ours, government agencies do not have and should not try to build the expertise to initiate investment ideas. While the government should initiate programs to encourage specific types of investment (investment in R&D should be preferred over investments in mergers, for example), the government should be in the position of responding to specific investment proposals. There are exceptions to this general rule. In infrastructure development, for example where government is the primary investor, the government, of course, must initiate projects.

Incentives Must be Flexibly Tailored to Specific Businesses

The competitiveness of different businesses depends on different elements in their cost structures. While manufacturing costs may be the key for some businesses, in others it may be applications engineering or marketing and distributions. Industrial policies that designed to encourage businesses to become strong international competitors should target key areas of cost leverage precisely.

For example, in businesses for which applications engineering is critical, tax benefits for capital investment or grants for R&D assistance are likely to be irrelevant. Policies to assist in the bidding process for particular orders, or in test marketing and software development would be far mor useful. Similarly, in businesses for which large distribution scale on a country-by-country basis is critical, export financing, R&D assistance, or capital investment incentives are only marginally useful. Selectively targeted measures to assist overseas distribution investments would be more important.

Blanket assertions - that the U.S. government should

provide more funding for R&D or better incentives for capital investment or more export financing - miss the crucial point: key competitive cost factors differ from business to business. To be efficient, policy mechanisms must be carefully tailored to the particular needs of each type of business. Only then can federal assistance be used efficiently to produce higher incomes and more jobs for U.S. workers. Because industrial policy must be flexible, government officials must have a range of financial tools at their disposal to use as incentives.

THE INTERNATIONAL RAMIFICATIONS

Critics of industrial development policies often point to the presumed threat that these policies pose to international economic cooperation. What will happen if every nation is selectively assisting its companies to compete internationally?

To address this question, it is necessary to return to the fundamental goals of economic development stated earlier. If government policies (whether macroeconomic or targeted) boost investment for product and process innovations, assist the industrial development of developing countries, or increase productivity, they are in the interest of world economic development.

If policies, whether macroeconomic (currency devaluations or artificially high interest rates) or targeted (export subsidies, quotas and voluntary restraint agreements or operating subsidies for uncompetitive products) are simply allowing uncompetitive products to be sold because of protection or subsidy, then all nations will suffer in the long run.

Currently, both productive and protectionist measures exist in all countries, including the U.S. However, the threat of protectionism is growing because of massive world

unemployment and declining real incomes. In response to this threat, we need to work toward international conventions which allow countries to encourage productive investment and discourage reliance on protectionist measures. This type of realistic trade policy would promote world economic prosperity. The real danger to international economic cooperation will occur if current restrictive economic policies continue to increase world unemployment. Simple notions of free trade do not fit well in today's world of rapid economic change. The increase of protectionist sentiment in the Congress and around the world is evidence of this fact. The alternative to protectionism is to provide governments the flexibility to encourage economic growth through productive investment.

THE RISKS ASSOCIATED WITH INDUSTRIAL POLICY

It would be naive to think that the kinds of policies I am suggesting do not create political risks.

- Whenever government funds are to be handed out, corruption or political favoritism can occur.
- Some funds will be wasted and misused due to inexperience or incompetence of appointed officials.
- Political pressure groups may force funds to be directed to unworthy projects -- "lemon socialism" -- or to serve their own special interests.

While these risks are real, I believe that adequate congressional oversight can minimize them.

THE RISKS ASSOCIATED WITH NOT CONDUCTING AN INDUSTRIAL POLICY

Far more serious are the risks of not instituting positive development policies. The buoyant U.S. economy of the 1950's and 1960's was founded in a benign international

competitive environment. While the U.S. was pioneering new industries - plastics and fibers, semi conductors and computers, electronic instruments, jet aircraft and industrial machinery - other industrialized countries were recovering from the devastation of war and rebuilding their basic industries and infrastructures. As a result, the U.S. had the benefit of a relatively non-competitive international marketplace. A large home market stimulated the growth of autos and other manufacturing and capital goods industries. In addition, many U.S. industries in their early stages, especially high technology businesses, received a significant boost through national defense procurement.

The international industrial arena of the 1980's and 1990's will be very different from that of the 1950's and 1960's. The U.S. will be confronted with a highly competitive international environment that will threaten many existing businesses and make it far more difficult to develop successful new ones.

An increasing number of businesses that comprised our traditional U.S. industrial base, such as steel, fibers, shoes, clothing, metal parts, ships, and small appliances, will be subject to low-wage competition. Korea, Brazil, Singapore, and other rapidly developing countries will increase the sophistication of their production. Other developing countries with lower wages - such as the Philippines, Malaysia, and Sri Lanka - will move into industries in which these more developed low-wage economies are now dominant.

Meanwhile, in certain high-growth industries where the U.S. currently has a leading position - such as computers, semi conductors, aircraft, industrial machinery, pharmaceuticals, scientific instruments, and offshore technology - foreign companies, assisted by their governments, are actively

seeking to close the gap and move ahead. While the strongest U.S. companies in these industries appear unassailable, one must remember how impregnable General Motors and U.S. Steel seemed 10 or 15 years ago.

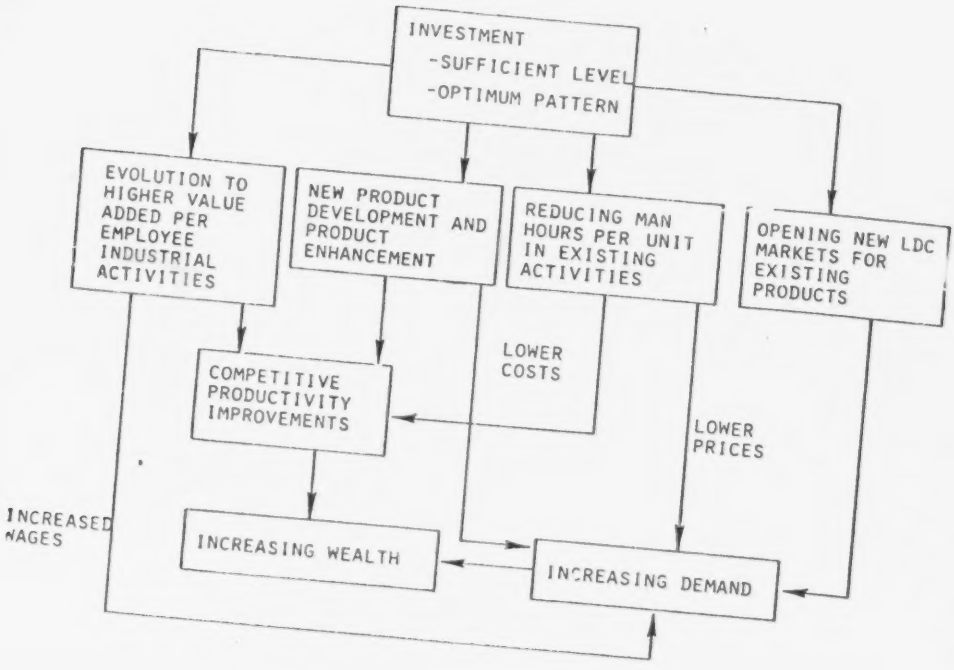
The past examples of the U.S. decline in steel and televisions are being replicated in other industries today. In 1976, the U.S. had a positive trade balance of $200 million in machine tools, long a leading American industry. By 1979, the U.S. was importing $400 million more in machine tools than it exported. Perhaps even more ominous for the future, the U.S. position in high-technology numerically controlled machine tools has deteriorated substantially. For example, between 1976 and 1980, Japanese production of numerically controlled lathes increased by 350 percent and German production increased by 310 percent. At the same time French production increased by 340 percent and British production increased by 300 percent. U.S. production increased by only 160 percent. In 1980, Japanese producers captured 53 percent of the U.S. market in numerically controlled lathes, up from less than 10 percent only five years ago. As in consumer electronics, the Japanese are using product and process technology at both the component and final product levels to achieve cost and quality advantages over U.S. producers.

The industrialized trading partners of the U.S. also are seeking to attain competitive leadership in other future growth industries. Foreign companies and their governments are undertaking programs to encourage new development in lasers, biotechnology, composite materials, robotics, flexible machinery and various microelectronic technologies. Today's U.S. civilian trade balance in manufactured goods is based on industrial machinery, aircraft, computers and perpherals, electronic instruments and speciality chemicals. In

all of these industries, foreign companies are making significant advances through aggressive investments.

No set of macroeconomic policies will reverse this trend. Economic development policies will be difficult to implement and will embody many problems and risks, but the risk of not instituting such policies -- the risks of continued economic stagnation and competitive decline -- are even greater.

EXHIBIT 1
THE ROAD TO WEALTH CREATION



INCREASING PRODUCTIVITY BUT NOT DEMAND MEANS HIGH UNEMPLOYMENT AND STAGNATION.

INCREASING DEMAND WITHOUT PRODUCTIVITY MEANS INFLATION AND EVENTUAL STAGNATION

Mr. LUNDINE. Thank you.

Mr. Oswald, I wonder if we can intrude on your time now? Senator Levin from Michigan is here, and I know he is in a hurry, and so am I. So if you would not mind, I will ask him to proceed now.

Senator LEVIN. We will just move you aside figuratively and not literally here.

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator LEVIN. Thank you. And thank you very much for your bill, for your hearings, for your invitation to participate with you in this effort in the Senate, for your invitation this morning, and for your accommodating my schedule. That is about five "thank yous," to start with.

I am pleased to cosponsor the companion bill in the Senate, S. 2518. I believe the legislation will be helpful in pointing us to the long-term strategy of economic development. Right now, Mr. Chairman, most of our attention is focused on the immediate problems we confront, the high unemployment rate, the interest rates, the budget deficits, the lack of economic growth and response. And given the seriousness of these immediate problems, it is a good thing we are focusing on them.

No matter how we manage to muddle through these problems, no matter what quick fix we use to get by this time, we are still going to face some fundamental questions about the nature of our economic system. The plain truth is that for a number of years we just put our economic engine on automatic pilot and let it run down the highway. It worked. We had so much technology, so much of an edge over our competitors, that we could afford to operate that way.

But things have changed. Energy costs have soared. Productivity has sagged. And our competitors have advanced. And our access to foreign markets has been restricted in many cases.

In this new environment, we cannot afford to continue operating as we have been. We need to look at where we are, how we got there, and, most importantly, where we want to be and how we can get there from here.

In that context, it seems to me that one of our major structural causes of our current plight springs from the kind of relationship that we have allowed to develop among labor, management, and Government in this country. During the salad days of unlimited growth, we allowed an environment to grow which pitted these entities against each other. Each seemed to view their relationship as a zero-sum game in which someone had to win and someone else had to lose. The result was a lack of cooperation and a loss of competitive strength.

If we are to improve our economic climate and find ways to adapt to new markets, new technologies, new organizational designs, we have to have a structure which allows Government, labor, and management to work together. Recent economic conditions—reaching a crisis state in distressed industries like trucking, steel, and automobiles—have produced temporary truces. But unless we build on the base which these actions have created, we will lose the

momentum and forgo an opportunity to structure industrial relations in this country.

In order to avoid that, H.R. 6099 and S. 2518 would establish a national industrial development board charged with the responsibility of proposing national industrial development policies. And I will not identify the functions of that board, although it is in my testimony. I would ask that that be made a part of the record, to save time, Mr. Chairman.

Mr. LUNDINE. Without objection, your entire statement will be made a part of the record.

Senator LEVIN. In conclusion, shortly before he left office in 1980, Secretary of Transportation Neil Goldschmidt issued a report on the state of the auto. However, it did more than look at a specific industry. It also addressed some of the basic concerns that you have indicated in this bill that I have raised here briefly.

In that report, Mr. Goldschmidt called for the development of what he called a new socioeconomic compact between Government, management, and labor. That is precisely the task I think we have to move ahead on, and that is what the national industrial development board would tackle.

We simply must find ways to transform often antagonistic sectors of our economy into a multifaceted force for rational and sustained national economic development.

Again, Mr. Chairman, my thanks to you for your initiative in this area. My thanks to your panel for their willingness to step aside briefly so that I could spend these few minutes with you.

[The prepared statement of Senator Levin follows:]

TESTIMONY OF SENATOR CARL LEVIN

MR. CHAIRMAN:

I WOULD LIKE TO THANK YOU FOR GIVING ME THE OPPORTUNITY TO TESTIFY BEFORE THE COMMITTEE ON OUR NATION'S INDUSTRIAL POLICY IN GENERAL AND ON H.R. 6099 IN PARTICULAR. I AM PLEASED TO BE THE SPONSOR OF THE COMPANION BILL IN THE SENATE, S. 2518. THIS LEGISLATION WILL BE HELPFUL IN POINTING US TOWARD A LONG-TERM STRATEGY OF ECONOMIC DEVELOPMENT.

RIGHT NOW, MOST OF OUR ATTENTION IS FOCUSED ON THE IMMEDIATE PROBLEMS WE CONFRONT -- THE HIGH UNEMPLOYMENT RATE, INTEREST RATES, THE BUDGET DEFICIT, THE LACK OF ECONOMIC GROWTH AND RESPONSE. AND GIVEN THE SERIOUSNESS OF THESE IMMEDIATE PROBLEMS, IT IS A GOOD THING THAT WE ARE FOCUSING ON THEM. BUT NO MATTER HOW WE MANAGE TO MUDDLE THROUGH THESE PROBLEMS, NO MATTER WHAT "QUICK FIX" WE USE TO GET BY THIS TIME, WE ARE STILL GOING TO NEED TO FACE SOME FUNDAMENTAL QUESTIONS ABOUT THE NATURE OF OUR ECONOMIC SYSTEM.

THE PLAIN TRUTH IS THAT FOR A NUMBER OF YEARS WE JUST PUT OUR ECONOMIC ENGINE ON AUTOMATIC PILOT AND LET IT RUN DOWN THE HIGHWAY. AND IT WORKED. WE HAD SO MUCH TECHNOLOGY, SO MUCH OF AN EDGE OVER OUR COMPETITORS, SO THAT WE COULD AFFORD TO OPERATE THAT WAY. BUT THINGS HAVE CHANGED. ENERGY COSTS HAVE SOARED, PRODUCTIVITY HAS SAGGED, OUR COMPETITORS HAVE ADVANCED, AND OUR ACCESS TO FOREIGN MARKETS HAS BEEN RESTRICTED.

IN THIS NEW ENVIRONMENT, WE CANNOT AFFORD TO CONTINUE OPERATING AS WE HAVE BEEN. WE NEED TO LOOK AT WHERE WE ARE, HOW WE GOT THERE, AND MOST IMPORTANTLY, WHERE WE WANT TO BE AND HOW WE CAN GET THERE FROM HERE.

IN THAT CONTEXT, IT SEEMS TO ME THAT ONE OF THE MAJOR STRUCTURAL CAUSES OF OUR CURRENT PLIGHT SPRINGS FROM THE KIND OF RELATIONSHIP WE HAVE ALLOWED TO DEVELOP BETWEEN LABOR AND MANAGEMENT AND GOVERNMENT IN THIS COUNTRY. DURING THE "SALAD DAYS" OF UNLIMITED GROWTH, WE ALLOWED AN ENVIRONMENT TO DEVELOP WHICH PITTED THESE ENTITIES AGAINST EACH OTHER. EACH SEEMED TO VIEW THEIR RELATIONSHIP AS A ZERO-SUM GAME IN WHICH SOMEONE HAD TO WIN AND SOMEONE ELSE HAD TO LOSE. THE RESULT WAS A

LACK OF COOPERATION AND THE LOSS OF COMPETITIVE STRENGTH.

IF WE ARE TO IMPROVE OUR ECONOMIC CLIMATE AND FIND WAYS TO ADAPT TO NEW MARKETS, NEW TECHNOLOGIES, NEW ORGANIZATIONAL DESIGNS, AND NEW PATTERNS, WE HAVE TO HAVE A STRUCTURE WHICH ALLOWS GOVERNMENT AND LABOR AND MANAGEMENT TO WORK TOGETHER. RECENT ECONOMIC CONDITIONS -- REACHING A CRISIS STATE IN DISTRESSED INDUSTRIES LIKE AUTOS AND STEEL AND TRUCKING -- HAVE PRODUCED AD HOC "SOLUTIONS" AND TEMPORARY TRUCES. BUT UNLESS WE BUILD ON THE BASE THAT THESE ACTIONS HAVE CREATED, WE WILL LOSE MOMENTUM AND FORGO AN OPPORTUNITY TO STRUCTURE INDUSTRIAL RELATIONS IN THIS COUNTRY.

IN ORDER TO AVOID THAT, H.R. 6099 AND S. 2518 WOULD ESTABLISH A NATIONAL INDUSTRIAL DEVELOPMENT BOARD CHARGED WITH THE RESPONSIBILITY OF PROPOSING NATIONAL INDUSTRIAL DEVELOPMENT POLICIES. THE BOARD'S SPECIFIC DUTIES WOULD BE TO MAKE RECOMMENDATIONS FOR NATIONAL DEVELOPMENT PRIORITIES AND TO MAKE RECOMMENDATIONS AT THE REQUEST OF EXECUTIVE AGENCIES OR CONGRESSIONAL COMMITTEES ON SPECIFIC INDUSTRIAL POLICY PROBLEMS PENDING BEFORE THEM. SINCE ANY STRATEGY PROPOSED BY THE BOARD CAN ONLY SUCCEED IF IT HAS THE COMMON SUPPORT OF THE PRINCIPAL SECTORS OF THE ECONOMY, THE BOARD WOULD BE A QUADRIPARTITE BODY COMPOSED OF THE LEADING REPRESENTATIVES OF BUSINESS, LABOR, GOVERNMENT AND THE PUBLIC. THE MEMBERS OF THE BOARD WOULD BE APPOINTED BY THE PRESIDENT FROM AMONG THE CANDIDATES NOMINATED BY THE MAJORITY AND MINORITY LEADERS OF THE SENATE AND THE SPEAKER AND MINORITY LEADER OF THE HOUSE OF REPRESENTATIVES AND WOULD BE ELIGIBLE TO SERVE UP TO TWO SIX-YEAR TERMS. THE BOARD COULD HOLD HEARINGS AND WOULD PUBLISH A BRIEF ANNUAL REPORT OUTLINING DEVELOPMENT PRIORITIES FOR THE UNITED STATES AND RECOMMEND LEGISLATIVE AND ADMINISTRATIVE ACTIONS IN SUPPORT OF THEM.

MR. CHAIRMAN, SHORTLY BEFORE HE LEFT OFFICE IN 1980, SECRETARY OF TRANSPORTATION NEIL GOLDSCHMIDT ISSUED A REPORT ON THE STATE OF THE AUTO INDUSTRY. BUT IT DID MORE THAN SIMPLY LOOK AT A SPECIFIC INDUSTRY. IT ALSO ADDRESSED SOME OF THE BASIC CONCERNS THAT I HAVE RAISED HERE. IN THAT REPORT, MR. GOLDSCHMIDT CALLED FOR THE DEVELOPMENT OF WHAT HE CALLED A NEW SOCIOECONOMIC COMPACT BETWEEN GOVERNMENT AND MANAGEMENT AND LABOR. THAT IS PRECISELY THE TASK THAT I THINK WE HAVE TO MOVE AHEAD ON -- AND THAT IS PRECISELY THE TASK THAT THE NATIONAL INDUSTRIAL DEVELOPMENT BOARD WOULD TACKLE.

WE SIMPLY HAVE GOT TO FIND WAYS TO TRANSFORM OFTEN ANTAGONISTIC SECTORS OF OUR ECONOMY INTO A MULTIFACETED FORCE FOR RATIONAL AND SUSTAINED NATIONAL ECONOMIC DEVELOPMENT.

Mr. LUNDINE. Thank you very much, Senator. I do not have any questions, since we are both sponsoring the same bill.

Senator LEVIN. It is more fun that way, actually.

Mr. LUNDINE. I do appreciate your coming over. Now I must ask the indulgence of the witnesses and the audience. We have a series of votes on the House floor which should take 20 to 30 minutes, and then I think we will be able to finish up uninterrupted.

We will recess for approximately 20 minutes.

[Brief recess.]

Mr. LUNDINE. The Economic Stabilization Subcommittee will reconvene. We will be pleased to hear from Mr. Oswald.

STATEMENT OF RUDOLPH OSWALD, DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL-CIO)

Mr. OSWALD. I would like to take a few minutes to react to some of the comments made by the other presenters this morning, and say in essence that while the United States professes to have no industrial policy, many of its actions do have a substantial effect on the Nation's industrial base. Moreover, that impact varies substantially among different industries.

For example, the tight monetary policy that is currently being pursued is described as an across-the-board policy. Its impact, however, is substantially more severe for the housing industry and the basic manufacturing sectors than it is for some of the industries that have very little capital requirements, or that are not carrying large inventories that they must finance through loans that carry high interest rates. So, in effect we have an industrial policy which has killed the housing industry in this country through tight money and also has had a tremendous impact on our competitiveness in international trade.

During the past 18 months the impact of our tight monetary policy has raised the dollar by 25 percent against the yen and the mark. It is of questionable validity to say that our steel industry is not competitive with the Japanese or that steelworkers should take a 25 percent cut in wages when the yen has dropped by 20 to 25 percent. This drop did not occur because of the volume of trade that we do with the Japanese, but because of the value of the dollar and our high interest rates which caused the dramatic change in exchange rates. We need to consider the effect of these different policies on different industries.

Another example is the notion that we have nondistorting tax policies that bring about broad-based development in this country. For a number of years, our laws have allowed the issuance of tax-free industrial development bonds. On the other hand, we have been phasing out the Economic Development Administration, which reviewed the need for loans and the availability of credit on a disaggregated basis. Through the back door however, we give all sorts of tax concessions through industrial development bonds, with most of the money going to outfits like K-Mart and McDonalds. That is hardly economic development.

It seems to me that this sort of backdoor industrial policy really needs to be examined and we need to develop some sort of an alter-

native mechanism that doesn't limit industrial policymaking to Government agencies. There are interconnections between Government policies and we should have the major actors in our economic system joining together in a collective and coordinated effort to assess the results of these economic policies, as well as the implications for the future course of the economy.

For that reason, in August of 1980 our executive council supported very strongly the establishment of a tripartite reindustrialization board that would provide the sort of leadership to review the effect of actions and policies on our economic structure, and whether they deter or promote the growth of different industries in different areas of the country.

We believe both the sectoral and geographical implications are essential elements of that sort of program. I would not characterize it as Mr. Byrom would as an elite in Washington that determines everything. Rather it is essentially the opposite. It is the bringing together of business, labor, and Government to achieve an overall view of industrial policy.

But I think it has to be more than just a talking organization. That organization, I think, needs to be able to provide an overview of the elements that affect industrialization. There are a couple of other bills that have been introduced in the Banking Committee that I think deal with parts of these issues. Mr. Guarini has sponsored a bill, H.R. 6000, that talks of a reindustrialization finance corporation, something like the RFC that operated in the thirties that helped certain industrial sectors as needed, as well as assisted in the development of new industries such as synthetic rubber and aluminum to meet the wartime need for those products.

There is also legislation that has been introduced by Mr. Minish, H.R. 14, that talks of a national development bank that would help rebuild the country's public infrastructure, which has been falling apart. One publication after another has highlighted this problem. I guess most recent is the current issue of U.S. News & World Report that reports that $2.5 trillion is needed for this purpose.

But we think there is a need to put together an institutional arrangement that provides direction to the financing and the integration of our infrastructure. It must look at our education and training needs, the implications of international trade, the adjustment mechanisms that we have, and pull all of these elements together.

I agree with Mr. Magaziner that a 32-member committee seems a little bit large to be efficient. But I think that the important thing is that it be a committee that has outstanding people who would command respect in their own communities as well as other communities. The committee members would provide a sense of direction for economic development, and the committee would have the ability to apply policies that really have an impact on sectoral and regional growth. It would provide the sort of developmental guidance and assistance that our country is not receiving currently.

Mr. Magaziner raised the question of the risk of favoritism and other things. I think those same risks exist in our current arrangement where private banks do the lending, and in the everyday functioning of the marketplace. A prime example is the favoritism that is based on a variety of friendships and other things. If anything, I think that broadening the decisionmaking base to include

business, labor and government as a part of an economic industrialization board would provide a better framework.

We have had a number of chats in your absence, and I think maybe we might be more responsive to your interests if we respond to questions rather than my trying to take any more of your time formally.

The lengthy statement I submitted spells out in more detail my concerns with unemployment; the need to address those high levels of unemployment; the heavy impact of the current policies on the employment situation; and the very dismal outlook in the near term and even the next 2 or 3 years, for restoring a healthy level of employment.

Clearly the purpose of the economy is to produce goods and services, for people to be able to improve their life and to be able to work. That is what we would like to see industrial policy provide.

Thank you.

[The prepared statement of Mr. Oswald follows:]

STATEMENT OF RUDOLPH OSWALD, DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS,
BEFORE THE ECONOMIC STABILIZATION SUBCOMMITTEE
OF THE HOUSE BANKING, FINANCE, AND URBAN AFFAIRS COMMITTEE
ON U.S. INDUSTRIAL STRATEGY

September 22, 1982

I appreciate the opportunity to present before you the views of the AFL-CIO on U.S. Industrial Strategy. The subject is of vital importance to the workers, and indeed, to all the citizens of this country.

Recognition of the need for a national industrial policy in the United States has become widespread. The American economy is experiencing the highest and most extended period of unemployment since the Great Depression. The growth of the economy has stopped in the 1980s and our balance of payments worsened. These events would be bad enough if they were purely cyclical in nature, with the economy rebounding after a downturn. Underlying these setbacks, however, is a much more serious and enduring problem: the industrial base of the American economy is in fact eroding. That picture dramatizes the need to reindustrialize the American economy. There is no coherent national policy to reverse this ominous trend. Instead, the Administration would turn back to 19th century economic nostrums and would abrogate all responsibility to Adam Smith's "unseen hand." America needs policies, including an industrial policy, that meet the nation's needs for full employment and expanded noninflationary production.

Reaganomics instead of providing the promised instant economic recovery has plunged the nation into the worst recession since the Great Depression. The sharp drops in the nation's output, leaves the country producing less than it did three years ago. Industrial production continues to decline with another sharp decline reported for August.

The unemployment rate which had been 5.8 percent in 1979, and 7.2 percent in July 1981 has soared to 9.8 percent -- that represents 10.8 million unemployed people. In addition, there are those too discouraged to seek work and those working part-time involuntarily or a total of 17.9 million persons affected by loss of income and work opportunities.

At the same time, the excessive unemployment and idle capacity is causing the loss of hundreds of billions of dollars in foregone product and income that can never be recovered. The optimistic Reagan Administration mid-year budget review assumed a 9.2 percent average unemployment rate for 1982 and 8.4 percent for 1983. If, in light of the current 9.8 percent unemployment rate, a more realistic average of 9.5 percent for 1982 is assumed, the 1983 average is apt to be close to 9 percent. On the conservative basis of a 2.5 percent decline in GNP for every 1 percent increase in unemployment, the country loses between $300 and $400 billion a year in goods, services, savings and capital investment.

While the need for an extensive reindustrialization effort has been widely recognized, there is no consensus on the policies needed to achieve this goal. The reason for this lack of consensus lies predominantly in different perceptions regarding overall economic policy. First of all, there clearly are <u>sectoral</u> and <u>regional</u> problems in the economy, and aggregate policies whether focussed on supply, demand or even a sensible combination of both will not be enough to meet the nation's industrial problems. The nation's economic problems do not exist solely at an aggregate or across-the-board level, but in specific industries, regions, and income categories. Accordingly, the current infatuation with supply-side economics, tight money and diminution of governmental responsibility, ignores the true locus of the nation's economic problems.

Unfortunately, the supply-side fad has been used by the Administration to justify a set of economic policy proposals that are very costly in terms of the revenues lost through tax cuts, and diminish the standard-of-living of low-income households through cuts in Federal programs. The business tax cuts are much too costly, totally ignoring the need to target tax assistance to the specific industries and areas that are in need of assistance. Moreover, the individual tax cuts are grossly inequitable, giving vastly disproportionate tax reductions to upper income households.

On the business side, the Administration backed rapid and arbitrary speed-up in depreciation write-offs render the concept of business income for tax purposes meaningless. Huge revenue losses result and the corporate contribution to the costs of government is slashed.

The across-the-board nature of this tax cut ignores the earlier strength in aggregate investment. For example, non-residential fixed investment remained above 11 percent of GNP during 1978, 1979, 1980, but has fallen in 1981 and 1982 as a result of the Reagan policies. Moreover, during the thirty years prior to 1978, non-residential fixed investment never exceeded 11 percent of gross national product. If there was something wrong with the supply side, it definitely was not lagging overall business investment.

But today there is growing evidence of retrenchment in investment. The Commerce Department headlined in a press release of September 9 that "Business continues to trim 1982 capital spending plans." According to this most recent report, real capital spending will decline by 4.4 percent from 1981 to 1982.

Also, a New York Times feature story of August 8 contains the following concerning the private sector:

> "Perhaps the most worrisome consequence of the current recession is that business is scaling back spending on capital investment and research and development, both of which are the underpinnings of tomorrow's growth. Metals companies, auto makers, railroads, airlines, utilities and electrical machinery concerns have all been reining in plant and equipment outlays for some time and are expected to continue to do so. A survey by McGraw-Hill shows that business will spend only 3.9 percent more on investment projects in 1982 than last year. Adjusting for inflation, that represents a 4.5 percent decline.
>
> "Similarly, the annual percentage increase in spending on research and development has shriveled from 7.2 percent in 1980 to an estimated 3.8 percent this year, a disturbing figure for a nation that has prided itself on innovation."

In the public sector, a comparable situation is reflected in a key sentence which reads,"Aging and neglected, the nation's network of roads, bridges, sewers and rails is nearing collapse," in a lengthy article in the August 2 issue of Newsweek entitled "The Decaying of America." Such conclusions are supported by data on the annual rate of state and local public construction. Adjusted for price change, to provide a measure of physical volume, the annual total declined in each year since 1978, with the 1981 total being 16 percent below 1978. Notable declines have occurred in selected construction categories, including highways and streets, sewer systems, water supply facilities, and housing and redevelopment.

In the headlong drive to bestow massive tax cuts upon private business, while cutting government capital programs, the Administration is ignoring the crucial importance of the nation's infrastructure to private sector productivity. For example, as the network of roads, rails and ports is allowed to deteriorate, there are delays in transporting goods which are reflected in cost and price increases. Expansion of business may be discouraged by inadequate sewer and water facilities, and by the inability of workers to get to work on time because of frequent breakdowns by inadequately maintained public transit facilities.

The deterioration of public facilities must therefore be reversed if we are to be able to rebuild our industrial base. Accordingly, the Administration's cut in programs that contribute to public capital formation are inconsistent with the goal of promoting economic growth. Such programs as the Economic Development Administration (EDA), Urban Development Action Grants (UDAG), mass transit, rail subsidies, highway construction, and water purification support general business activity and should not be cut.

While the private business sector as a whole is now lagging and overall manufacturing capacity utilization is below 70 percent, several sectors that are essential to a diversified industrial economy have had severe problems. For example, basic steel, iron and steel foundries, and the automobile industry have all experienced precipitious declines in output. During the past twelve months (July 1981-July 1982), the Federal Reserve Board's indexes of industrial production for these essential industries declined dramatically. The basic steel index declined 43 percent, the iron and steel foundries index dropped 36 percent, and the tire production index plummeted 19 percent. These industries are basic to a productive industrial economy because they provide materials needed to produce other products and they generate demand for the products of other sectors.

These declines demonstrate that across-the-board business tax cuts are not the appropriate remedy for the nation's industrial problems. Rather, if tax cuts are to play an efficient role in the nation's reindustrialization efforts, they must be targeted to those industries that are essential to an industrial economy and are in need of this assistance.

Just as all industries would not warrant tax benefits under a coherent industrial policy, not all areas have an equal need for reindustrialization. For example, preliminary state and area data for June 1982 (the latest available

at this time), reveal that many metropolitan areas had unemployment rates substantially in excess of the national average of 9.5 percent. For example, many cities in the nation's older industrial heartland had extremely high unemployment rates. These include such cities as: Decatur, Illinois with a 16.2 percent rate; Muncie, Indiana with a 13.5 percent rate; Flint, Michigan, with an 18.6 percent rate; Jersey City, New Jersey, with a 13.4 percent rate, Buffalo, New York, with a 12.2 percent rate; Youngstown, Ohio, with an 18.4 percent rate; and Johnstown, Pennsylvania, with a 15.1 percent rate. Higher than average unemployment was not, however, concentrated solely in the nation's older industrial cities. Many Southern and Western cities also had abnormally high rates of unemployment, including Mobile, Alabama at 13.6 percent; Fort Smith, Arkansas at 11.6 percent; Modesto, California at 19.0 percent; Lakeland, Florida at 15.4 percent; Alexandria, Louisiana at 12.2 percent; Eugene, Oregon at 11.7 percent; and Tacoma, Washington at 12.8 percent. While the Southern and Western states have generally not experienced increases in joblessness that were as dramatic as those in the Northeast and Midwest, these data demonstrate that no regions are totally immune from industrial decline. The implication for industrial policy are quite simple: in addition to targeting by industry, reindustrialization resources must also be targeted by area.

In addition it should not be forgotten that these high rates of unemployment which are largely the result of painfully restrictive demand management policies, have deleterious implications for the supply-side. Specifically, the quality of human capital is diminished by periods of high unemployment. People who cannot get jobs because of this intentionally induced economic sluggishness are delayed in developing job skills, and people who are laid off tend to lose job skills. The stock of <u>human</u> capital declines, thereby retarding productivity growth.

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During the past twelve months, the American share of the world market for manufactured goods declined and the U.S. share of domestic market for manufactured goods also declined. This deindustrialization resulted in the loss of at least 1.5 million jobs in manufacturing.

The U.S. trade balance suffered a record $40 billion deficit in 1981, and in the first six months of 1982, the deficit was already over $18 billion in spite of a big drop in oil imports. Other nations increased their barriers to imports of U.S. goods and subsidized their exports to the U.S. No effective action has been taken to halt this trend or to guide increased capital flows to basic economic sectors that need modernization and expansion.

The Administration's monetary policies raised the value of the dollar, encouraging imports and retarding exports. These monetary policies raised the value of the dollar by 20 percent against the Japanese yen and 22.4 percent against the German mark between December 1980 and July 1982.

This country is still the greatest economic productive power on earth, although the U.S. lead is decreasing. The country must begin to sort out national priorities and channel resources into areas that will modernize private and public facilities and restore the national economy to a condition of stable growth. Failure to follow a course to achieve these objectives, the country will continue to lag in productivity growth and international trade; it will continue to have significant portions of its human and machine resources remain idle for extended periods of time; it will continue to suffer a reduction in the standard of living of its people.

A common thread that runs through the economies of countries that have grown faster than the U.S. is their adoption of a coordinated industrial policy that systematically incudes the views of labor, industry and the public. By contrast,

the Administration would have the U.S. at the mercy of the unseen hand. It is time to deal directly with the nation's many concrete and visible problems. To that end, the AFL-CIO has proposed the creation of a tripartite National Reindustrialization Board -- including representatives of labor, business, and the government -- which would develop a balanced program to insure the revitalization of the nation's sick industries and decaying communities, while at the same time encourage the development of new industries with promise for the future. The Board would encourage productivity growth, dissemination of research and development findings, and a balanced use of the nation's resources. It would target industrial sectors and regions that particularly need help. The National Reindustrialization Board would also be directed in the process of developing its policies and priorities to consult with the Council of Economic Advisors and the Federal Reserve Board. The composition of the Reindustrialization Board should automatically provide liaison with Congress, labor and industry.

This Board would also provide policy and priority guidance for the activities of a financing agency, patterned after the Reconstruction Finance Corporation of the 1930s and 1940s, which would be authorized to make and guarantee loans to finance approved reindustrialization ventures. Instead of using industrial development bonds to support more McDonald's and K Marts -- currently the biggest recipients of industrial development bonds financing -- the RFC would be concerned with the industrial base of the country.

Private pension funds could be encouraged to make investments in such financing arrangements to support and expand industrial employment in the United States. National policies that encourage investment abroad rather than in the United States undermine domestic employment opportunities.

The Reindustrialization Board would take into account more than just short-term profits for a corporation -- but rather would be attuned to the long-term development and welfare of the nation. The obsession of business with short-term goals needs to be balanced by a longer term perspective of the needs and aspirations of the American people.

The Reindustrialization Board would bring together all of the elements in economic society. It would insure that the interests of capital, of labor, and of the people are all made an integral part of the economic decision making process.

The AFL-CIO has recognized, for some time, that both private and public capital facilities were deteriorating. Actions to counter this source of economic debilitation were recommended in a resolution adopted at the November 1981 biennial convention of the AFL-CIO which included the two following paragraphs:

> "To modernize and revitalize the American economy, business, labor, and government should participate in a tripartite Reindustrialization Board. Under this board, a Reconstruction Finance Corporation would invest public and private funds in necessary reindustrialization projects.
>
> "The urban infrastructure of sewers, water systems, streets, and bridges needs to be renewed and the nation's transportation network must be upgraded for people and goods to move more efficiently. Railroads, highways, port facilities and airports are in desperate need of rehabilitation. Urban mass transit systems need support and modernization."

National Government Role in Economic Development

Any industrial policy that is formulated and pursued would mark a continuation of a long history of a government role in furthering the economic development of the country, instead of relying upon the guidance of an "invisible hand." In the 200 years since Adam Smith described such guidance, the economic preeminence of the United States developed with the participation of the federal, state and local government and periodic modifications of economic institutions through legislation.

Public canals and roads and private railroads and airlines were built with government assistance from the earliest years of the nation. Federal mortgage insurance spurred mass production of housing, and federal rural electrification loans advanced American agriculture. In more recent years, mass transit, water, and sewer systems have been built and renewed with federal assistance. The budget policies of the Reagan Administration are cutting back many of the federal programs that have been assisting state and local governments in the provision of public facilities and in economic development. It will not be possible for many states and localities to fill the gap. The public infrastructure which is an essential complement to private capital will not be fully maintained or adequately expanded.

An RFC Precedent

Following the Great Depression, during the years 1932-34, there were additional economic and financial institutions created such as deposit insurance, mortgage insurance, the Federal Home Loan Bank system, and the Reconstruction Finance Corporation (RFC). The latter was an industrial policy program. It not only provided capital to rescue ailing companies such as the B&O Railroad, it also helped start new firms, such as Reynolds Aluminum to increase industrial production capacity where needed. It also helped develop the synthetic rubber industry in World War II. The old RFC stopped making loans in 1953 and was completely liquidated in 1957.

In the pre-World War II depression years, the old RFC, in addition to making loans to private businesses, between 1935 and 1941 purchased about $700 million in securities from the Federal Emergency Administrator of Public Works (later the Public Works Administration), which supported public works construction activities that provided jobs in areas of high unemployment.

Today, that would be about $7 billion of construction projects, given the rise in construction costs. It also aided housing construction, through investments in the RFC Mortgage Company, later to become the Federal National Mortgage Association, which spun off the Government National Mortgage Association. Some $4 billion in loans were disbursed to help private financial institutions survive the depression.

The largest part of RFC investments was in RFC subsidiaries for essential defense and war production of metals, chemicals, rubber, etc., which absorbed about $21 billion, mostly during the years 1941-45.

However, the bulk of the loans to private, non-defense business, as well as direct loans made through the RFC mortgage company were made in the post-World War II period, to help in the industrial reconversion of the economy to a peacetime status. In the approximately 21 years of its active operation, from 1932 to 1953, the RFC either made direct loans and took immediate participation, or took deferred participation in business loans, as follows:

	Number	Amount
direct loans and immediate participations	35,852	$3,579,980,488
deferred participation	23,623	1,288,339,823
TOTAL	59,475	$4,868,320,311

The deferred participations were, in effect, loan guarantees for up to 75, 80 or 90 percent of the principal amount. Loans went to firms in almost every major category of manufacturing, as well as to enterprises in agriculture, forestry, fishing, mining, construction, wholesale and retail trade, services, transportation and other utilities. The current equivalent purchasing power of the approximately $5 billion in loans made by the old RFC would be several times that amount today.

The operations of the old RFC which continued into 1953 helped to lead the economy out of the Great Depression, to finance wartime defense production and to help in the post-war industrial expansion that supported a long period of

economic growth, relative price stability, and prosperity. It also provided a precedent for creation of an institution to help in industrial revitalization when the economy reaches a historic period of blocked growth. Apparently such conditions exist in the American economy today.

Proposed New Institutions

In order to get out of the current economic impasse and restructure the economy to a path of increased productivity and growth, a special institutional effort is needed. For that purpose, the AFL-CIO has endorsed adoption of an industrial policy, to serve both the private and public sector. Furthermore, it is believed that the desired type of policy can be implemented through the combination, with some modification, of three bills that have been introduced in the Congress. They are H.R. 14, to establish a National Development Bank, introduced by Chairman Minish, and H.R. 6000, to reestablish a Reconstruction Finance Corporation, introduced by Representative Guarini, with seven cosponsors, and H.R. 6099, introduced by Representative Lundine.

The thrust of H.R. 6099 should be broadened to provide for a National Industrial Development Board with appropriate authority to effectively recommend overall as well as specific industrial policies for the U.S. This Board should provide for the framework within which the National Development Bank (H.R. 14) and the Reconstruction Finance Corporation (H.R. 6000) function. The Board should be composed of members representing government, business and labor. The number 32 proposed in H.R. 6099 seems too large and unwieldy, and the AFL-CIO would propose 15 as a more manageable size.

Looking at the broad structural lines of the bills, there is an overlap in the authorization contained in H.R. 14 and H.R. 6000 for loans to private businesses. On the other hand, only H.R. 14, the National Development Bank bill, would

authorize loans to state and local governments for public works and facilities. A single bill could combine the functions of loans to private business and loans to the state and local governments. Such a bill would authorize the reestablishment of the Reconstruction Finance Corporation along the lines of H.R. 6000 and also of the National Development Bank, both to be under a single Board of Directors. The RFC could handle all the loans to private business, and the National Development Bank the loans to state and local governments. Each of the two lending organizations would be operated under a president or executive officer appointed by the Board of Directors. The Board of Directors would also be required to see that there was coordination between the two lending units to maximize economic development in areas where new construction or improvement of public facilities is needed to enhance the efficiency of the private business activities being assisted. Public facility loans should also be available in other areas in need of such loans to renew or expand public facilities required in the local economy. The issuance of capital stock of up to $5 billion to be subscribed by the Secretary of Treasury for the RFC and also for the National Development Bank should be included in the bill combining both agencies. However, the authority to issue obligations should be limited to five times the amount paid in capital stock for each of the two lending organizations. At a later date, the authority to issue obligations could be expanded, as needed.

The more detailed powers for the RFC that are spelled out in H.R. 6000, on the whole, would give guidance as to the directions and purpose to the operations of the RFC. One specific subsection of H.R. 6000, namely Section 5(f)(2), is considered of particular importance by the AFL-CIO. That subsection would provide that all obligations of the Corporation which are purchased by employee pension benefit plans shall be guaranteed by the Secretary with the full faith and credit

of the U.S. It is considered highly desirable by organized labor that pension funds should be used for reindustrialization and expansion that would provide employment, but with adequate security for the pension funds.

There should be added a requirement for an analysis of the impact upon areas that will be affected and upon the workforce employed in the affected industries. There will, no doubt, be a need for retraining of people to work with advanced technological production methods. There may also be displacement of people in some of the industries. Provision must be made for advance warning, adequate compensation to those affected, for retraining, job placement assistance, relocation assistance, and a pension supplement where age and other factors make it appropriate. Every consideration should be given to avoiding such displacements; but where it has a significant lasting adverse impact upon local government revenues, there should also be provision for compensation to the local government. Where there is a growth boom impact, at least temporary federal assistance for community facilities may be needed.

Types of Reindustrialization Efforts Needed

An economic reindustrialization effort still needed is the creation of synthetic fuels production facilities. When the major part of this effort is completed about a decade from now, there should be a significant reduction in U.S. dependence upon foreign oil imports to meet energy needs.

Major industries, such as steel and automobiles, need to go through a modernization retooling, involving tens of billions of dollars, to raise productivity and restore them to a better position in international competition.

Publicly owned infrastructure which is suffering from deferred maintenance must be improved, including replacement and expansion of large components in water, sewer, highway and mass transit systems, to enhance efficiency of economic functions and livability in major urban areas. Such improvements could also

could also maximize utilization of existing urban plants and minimize costly replication of facilities elsewhere, and help in dealing with large concentrations of unemployed youth.

As mass transit is encouraged, there will be an increased market for rolling stock, the buses and subway cars. Production capacity for the rolling stock in the country has to be expanded or the U.S. will be increasing its imports.

From a national, as well as local ecnomic perspective, as reindustrialization programs are instituted under federal auspices, insofar as possible, investment should be targeted to the urban areas that have underutilized private and public capital facilities. For optimum benefits, the public financial assistance and the private capital investment that it can leverage should be directed to enterprises with a commitment for employment of unemployed people in the designated areas. Such training and retraining as may be necessary could be done during the period of plant and equipment modernization and retooling to enhance growth in productivity.

To summarize, the nation cannot write off major industries in this country without paying for it dearly in the future. Nor can whole cities and regions of America be allowed to decay, without serious social and economic consequences.

It is important that America as a whole remain a diversified industrial nation, and this can best be accomplished through the active participation of government, labor, and industry in a major reindustrialization effort.

It is time for the U.S. to formulate a national industrial policy and abandon the irrational attachment to policies that threaten to bring about the wholesale condemnation of entire industries and regions. The AFL-CIO rejects the Administration's attempt to cast government as the whipping boy -- government spending, government deficits, government taxes, government borrowing, government

employees, etc. They are not the cause of every problem that can be identified as the Administration would have the people believe. The solution to America's problems is not to hamstring the Federal government by cutting its programs and its sources of income and weakening or undermining its laws, regulations, and standards used to protect health, safety, civil rights and the environment.

It is unconscionable to return to the burned-out America of the 1930s, when the willy-nilly movement of investment capital left the farm mortgage foreclosed, the top soil eroded and no hope of revival because no one had the purchasing power to lift an economy or re-open a bank. The AFL-CIO believes that government must enter into a new partnership with business and labor to revitalize the nation's economy.

Mr. LUNDINE. Thank you very much.

Mr. Byrom, you made the astute observation at the start of this that we could all agree on the diagnosis of the illness but probably the prescriptions were quite different. You said that you felt that one of the problems we have is an ad hoc response to crisis. How do we get away from that?

Mr. BYROM. While we were having a chance to talk, we found that there is a lot of commonality in our views. Let me, if I may, do a bit of bridging to get a couple of points across. Part of what disturbs me is that we always seem to attack the symptoms of the disease rather than the disease itself. We always seem to be trying to provide solutions to problems which have not yet been defined.

One of the reasons we are always approaching crisis on an ad hoc basis is that we have not defined our problems; I said I was excited about the fact that you were holding these hearings because to me it is the most positive thing that can happen at this point in time, for people like the three of us to realize we do, in fact, see the problems in the same way, and we may well see them the way you do.

It seems to me that rather than rush to try to find the solution to the dilemma we are in, we damned well better understand precisely what that dilemma is. Take the steel industry as an example. It is one I happen to be very, very familiar with, and we were talking about it during the recess. The steel industry, for a variety of reasons, has reached a point where some 40 percent of its so-called capacity is marginal capacity that should not be operating.

Now, my friends in the steel industry tell me my number is very high, that it is really only 15 or 20 percent; but I will stick with my 40 percent. What needs to be done, as far as I am concerned, is a rationalization of that industry, and this is true of a lot of other basic industries. Where that 40 percent of marginal capacity is abandoned, what does that do?

What does it do to communities, to individuals, and to stockholders? The stockholders of the steel industry really get clobbered. The cost of that abandonment today is, in my opinion, probably beyond the capacity of the private sector to underwrite by itself out of the

normal economic motivations for the use of money. That is probably the case because you see the steel industry members using cash flow to do things other than deal with the problems of the industry.

This happened in Great Britain. They liquidated their industry to the point where it needed complete overhaul. They perceived it was not within the capacity of the private sector to underwrite the abandonment, replacement and modernization of plants. They decided to nationalize. I would hope that would not be our solution.

Interestingly enough in Great Britain they spent several billion dollars to build modern technology plants with the idea that once they got them ready to operate, they would abandon the old, worn out plants. When they got to the point where they were prepared to abandon those plants, the MP suddenly said, what are you talking about, you are going to put my constituents out of work, you are going to ruin my district, economically you can't do that.

So for 4½ years the British Steel Corporation was required to operate all of the old, marginal plants, which then meant the new modern plants could only operate at 50 percent of capacity. The whole thing lost money like it was going out of style. If you want an example of the kinds of problems we are facing, you should look at what happened to the steel industry in Great Britain.

When you ask how do you avoid dealing with crisis on an ad hoc basis, I suspect we are going to have to continue that way for some period of time. What I am hopeful of is that hearings such as this will get us to the point where we will start to have some common agreement on the nature of our problem.

I don't think we have that yet. I don't think we understand how bad off this Nation is economically. I don't think we understand what kinds of things got us there. Let me give you an example.

Today if you want to build a coke plant necessary to produce iron, you had better build a 1-million-ton coke plant because $50 million of the cost will be for pollution control. I am not against that, but I am saying if you are going to have a quality of life requiring clean air, you are going to have economy of scale that allows the cost of preventing that pollution to be absorbed over a large volume of production so the unit cost is reduced.

Our present technology is such that a 1-million-ton coke plant is the smallest plant you ought to build. I might point out that 50 percent of the coke oven plants in the United States are over 25 years old, and even if Koppers builds them for you, they will wear out in 30 years. So, half of the coke production capacity in the United States is obsolete today.

There are 150,000-ton plants, 200,000-ton plants, 250,000-ton plants, and they are all owned by different people. Nobody has an incremental requirement for a 1-million-ton plant, so no one is building any coke plants. That is going to catch up with us at a point where the steel industry starts to move back. We will not have the coke capacity to supply the blast furnaces.

Now, these are the kinds of things that have to be understood because you don't solve your problems until there is agreement as to what the problems are. The fact that I say this is true doesn't make it true, but to me the principal thing that should be attacked now is how do we set up a factfinding mechanism that will allow

us to start to understand our problems so that we can then move on to solving them.

But until you have understanding of the problem, you are going to have to respond to crises with ad hoc solutions, and we will just dig ourselves deeper and deeper and deeper.

Mr. LUNDINE. Mr. Magaziner, as I understand it, your recommendation No. 6 of a policy board was essentially to try to develop the kind of credible information that Mr. Byrom was just talking about. In other words, we may have a lot of talk today about the diagnosis of the problems, but unless we demand consensus and demand that the principal people get involved in decisionmaking, both in the private and public sector, we are not going to have a real definition of the problem.

But Mr. Oswald is proposing that you go further than that and that you have an RFC or a bank and they actually make loans and decisions on loans. As I understand it, you didn't want to do that. You didn't want that board to be a national banker, if you will. Would you explain the reasons you wouldn't want that?

Mr. MAGAZINER. Yes. I think the board ought to be something separate. I don't disagree with an RFC concept, although I think it must be defined more carefully. Exactly what its functions are have to be clear. I don't think one big bank trying to do everything from helping certain industries rationalize to help others make risky investments can work, I don't think these functions should be combined.

But insofar as the board is concerned, when we work as we do for other governments in industrial policy areas, and you sit down in France, Germany, or Japan, with Government officials and industry associations, you have a very elevated debate. Where the Government people have been monitoring different industries, they have their views, they have a certain amount of knowledge and intelligence about the industries. The industry associations and companies, of course, have their own views, and the unions for those industries have views they have been analyzing, and you have a very intelligent discussion about what directions should be taken. That is a constant feature of life in those countries.

Here when we run into a problem in steel or elsewhere, then we convene a group ad hoc and people are getting together for the first time and the staff work hasn't been done in Government, and we try to do it rapidly and we come out with a lot of partial answers.

I think we have to have the mechanism more ongoing to produce a higher level of discussion, and that is what I would like to see that board do. If I could take the steel example, which is an industry I worked in for quite a while, you can see initially that the private actors in this country made a lot of poor decisions in terms of investment and that the Government was moved in the late sixties to protection.

I think 1967 was the first partial protection. That cost the Government money in terms of foregone tax revenue and it cost the consumer money, but nothing was done to discuss how the industry would regain competitiveness. Discussion was focused on the foreigners doing things unfairly.

Now in fact, regardless of subsidies, most of the steel plants in other countries are on a pure operating cost basis more competitive than ours. They produce steel at a lower cost. And we have to undertake a fairly significant rationalization program if we are to remain competitive in steel, which I think we must. The private sector didn't do that, and when they were given protection, they simply tried to diversify and made investments and so on.

The Government didn't have enough knowledge to really discuss with the companies what was going on, and it was only when the crisis really got bad in the late seventies, in the last 6 months of the Carter administration, that there were really serious discussions about what could be done. But the analysis that was done was too quick and was not of sufficient quality to really bring forward a plan. I think the biggest advantage of this board would be to have that kind of ongoing analysis and discussion.

Mr. OSWALD. Could I just add that you could have something like an industrial sector represented as a subcommittee of this board. If there is a particular problem in steel, the overall board would say we know we have a problem in steel but we are not experts in steel and we want the steel committee to review the thing. But we don't want them to make decisions for the whole country; we want those decisions to be referred to the overall board to see how they fit into what we view as a proper economic policy for the Nation as a whole.

I think you could do that also for areas of the country that have problems so that you could look at both specific area problems and specific industry problems.

Mr. MAGAZINER. I agree.

Mr. LUNDINE. Mr. Oswald, I just want to ask one more question about the board, and I don't mean to be fixed on that. You recommend, I believe, in your testimony a 9-member board, and I don't want to get into the 9 versus 32, and I am not hung up about 32. But, one problem I have with the concept that you are advocating is the idea that people are going to feel that big business, big government, and big labor are sitting down in Washington figuring out what is good for the country. They are going to feel that they will take the shaft when they do.

What about small businesses? What about those businesses trying to get in that Mr. Magaziner talked about in one of his points? Don't they have any voice? What about the consumer? Suppose a few people set out to solve the steel problem, and they agree that the answer to that is to do away with environmental protection. I didn't say you would, but that could easily occur?

Mr. BYROM. That would be too bad.

Mr. LUNDINE. It could occur if you had only those three parties at the table. What about the aspect of just big business, big labor, and big government being a part of your recommended board?

Mr. OSWALD. I recommended 15 rather than 9 members. The only thing is that usually a structure that gets up as high as 32 becomes relatively unwieldy. I would assume on the business side you are talking about representatives of both big and small businesses. I would assume you would be talking about financial representatives as well as industrialists.

I would say that I think the biggest problem in determining what you do with consumers and others is that we really don't have any good structure in our society to represent consumers. There are no automatically recognized consumer organizations. I know you do have the recommendation in here for an apartheid arrangement; I just don't know who you involve.

When you say big labor, it must be noted that it is a democratically elected, representative group that involves people from various sectors, not just the manufacturing sector. We represent people in governmental areas and service areas as well as manufacturing.

I think what we have done too much in the past is to say that there are a few government analysts who are going to review what is happening in steel and they will be maybe in the Department of Commerce. They won't have anything to do with the trade section of the Department of Commerce, they won't have anything to do with the manpower retraining areas of the Department of Labor, and they will have nothing to do with anything that the National Science Foundation may be doing in terms of R&D and other activities.

I really think that you need to have somebody that tries to bridge these different groups. That also involves private sector actors. It is not just a governmental activity.

Mr. LUNDINE. Mr. Byrom.

Mr. BYROM. I am bothered by something and I may sound as though I am an idealist and not very pragmatic, which I don't think is true.

I believe we can agree on the problem, which is the systemic failure of all of our institutions, political, economic, and social. Our institutions are pre-1940 institutions and all of our problems are post-1980 problems.

But we don't agree on how you deal with this. I happen to believe that the first thing you should do is decide what your mission is in a very abstract kind of way. We ought to be trying to figure out what the United States should be like 50 years from now because it will take us that long to go through all of the mechanisms to get there.

Although I nearly get thrown out of assembly halls for saying so; but having decided what the mission is, you have to set up measurable objectives which, if they are accomplished, would move to fulfillment of the mission. Only at that point do you decide how to organize, because the purpose of organization is to use a communication tool to implement your objectives.

Until this Nation knows what its objectives are, I think it is premature to talk about how to organize to deal with them. That is why I am excited about what you are doing here, because maybe this can be the starting point for finding out what we are trying to do as a society.

Mr. LUNDINE. That is so provocative; but out of courtesy to my colleague, I will call on Mr. Coyne.

Mr. WILLIAM COYNE. I want to thank you, Mr. Byrom, for your comments, and I want to say for my part I think you are directly on target: we haven't identified what the problem is. I also believe you are correct when you state we are in worse shape than most people believe we are and that until we identify the problem, there

is no way that we can provide a solution to it. I believe you are absolutely correct.

But you mentioned about some type of a committee to be formed, and we talked about a 32-member committee. I have seen committees that are good and bad, and in my judgment we have too many committees studying the same problem with no consensus on what the solution is, as you indicated in your earlier testimony.

I would just like to have your comments on where we ought to begin on that fact-finding committee. I think that would be interesting to this committee, to know if you have any suggestions. I know you haven't been able to give it too much thought in this brief period of time you are here, but if you could elaborate on what kind of a fact-finding committee that would be, what its makeup would be, how large it would be, it would be interesting to me.

Mr. BYROM. Let me say this. As I think you know, the CED has a subcommittee actively working on a policy statement on industrial strategy. As you know, CED's is a consensus-building process among a whole bunch of people who don't start off with the same views although it does not require everyone to agree because CED dissenting opinions which are recorded. But the very nature of the process means that it takes time, and I suspect we will be very fortunate if we come out with any kind of a statement before the end of next year. In fact, it encompasses so much that it may have to be two or three policy statements. We will be coming up with some recommendations on that.

Now you are asking me today what do I think we should do, and I am not that smart. I am sorry; I just am not. We have had other fact-finding attempts. The Council of Economic Advisers, when Hank Houthaker was a member of it, did an analysis of steel. Hank came in to see me and I said a whole lot of things I said today. He rejected it out of hand because fundamentally Hank is a classical economist, and I think part of our trouble is too many of our policies are made on the basis of classical economics by a bunch of people who don't understand the technology involved.

Somehow or another we cannot ignore the impact of technology on human beings, so we must have people who represent the stakeholders who will be involved. We need economists; I am not sure whether we need lawyers or not. [Laughter.]

We need representatives of labor. But again, what do we want? Do we want a macrolabor representative who is fundamentally a politician and who is just as inhibited as you people are by the need to get reelected. One of our problems is that the time frame of your office is out of phase with our problems. It takes a lot of courage for you to really address yourself to what we have to do 10 years from now when you have to run for office every 2 years.

I think our political system doesn't allow us to do the kinds of things that we need to do. As my Congressman knows, I don't think the State of Pennsylvania should exist. Pittsburgh and Philadelphia don't belong in the same State. And yet we are trying to make these kinds of difficult decisions with that kind of a societal organization.

All I am saying is I am excited at the opportunity to be here and sit and talk to you about this because one of the interesting things

I have found out about organizations is that no matter how wrong the structure is or how rigid the structure is, people of like mind who can agree as to what they are going to try to do can establish an informal organization that will work despite the fact that a formal organization won't.

What we have to do here, I think, is start to create the kinds of ad hoc, informal mechanisms that will allow us to start to understand the problems. I am amazed that the three of us stood here for an hour and we were damn near in agreement on everything we talked about.

Mr. OSWALD. [nods affirmatively].

Mr. MAGAZINER. [nods affirmatively].

Mr. BYROM. I came here expecting to be the odd man out on the panel.

Mr. LUNDINE. I was amazed, too. I wish we had recorded that.

Mr. BYROM. In answer to your question, I think that is what we have got to try to find out; rather than decide what the formal, immediate, rigid structure should be, let's deal with some ad hoc informal experiments as to how you can do this at the regional level. I will even be a party to it at the Federal level, except I don't think it will work at the Federal level.

Mr. WILLIAM COYNE. We had a chance to talk on the floor during the break, and one thing I asked Congressman Lundine was about the Jamestown experience you referred to earlier, and the fact that business and labor got together with other people in the community and were able to form a committee to come up with recommendations about how the industry can become more productive.

I just wonder: I am sure you are aware of the Westinghouse experience and their quality control.

Mr. BYROM. Yes.

Mr. WILLIAM COYNE. Is that something similar to what is happening in Jamestown?

Mr. BYROM. I think that is only a part of it. That is really sort of a quality circle kind of thing, more a matter of just very sound human relations. You know, one of the things we have lost an understanding of is that what makes things go is people.

Consider the Japanese. I got a letter from a guy named Koji Kobayashi, who is the top man in Nippon Electric. Years ago I gave a speech called "Hang Loose," and Koji had it translated and there were 200,000 copies of it distributed in Japan. My wife and I saw him recently. He said, you know, they talk about the Japanese management style, but everything I know, I learned from your husband. I am not saying that is true, and that is a very self-serving thing, but the Japanese didn't originate anything. What has happened is they have learned to be much better at doing things that we used to do very well, and we have to learn to do them again.

One of the ways you do it, as far as I am concerned, is to disaggregate our institutions. We ought to be making decisions and taking actions at the level closest to where the impact of the decision will be felt. Our organizations ought to be on that basis and we ought to be trying to do things at regional levels, not macrolevels.

I think there is a lot we could do in the Pittsburgh area. As you know, I have been Chairman of the Subcommittee on Economic De-

velopment there, and you and I have talked about these things. We have Hy Milton working on it, and I think the Pittsburgh region will figure out for itself what it has to do.

Mr. WILLIAM COYNE. Thank you.

Mr. Oswald, you had indicated about the article in Newsweek.

Mr. OSWALD. U.S. News & World Report.

Mr. WILLIAM COYNE. Yes. And what they talk about as a $2.5 trillion effort. I am just wondering about what your thoughts are on the structure, how that could be implemented. I am not saying you advocate that as an answer, but I just wondered what the vehicle would be for carrying some effort like that out.

Mr. OSWALD. I think that part of the problem is that currently we have no structure that brings together what I call the normal public infrastructure—the highways, the sewers, and so forth—with the problems of the coke ovens that Mr. Byrom talks about. When I advocate a national board, I don't disagree with Mr. Byrom that we need detailed area and industry investigations as a part of its mission. I don't in any sense advocate simply a macroapproach.

I think it is a question of how do you interlink the national responsibility to provide our infrastructure, and all of the data shows that has been going down in real terms. We have had a long-term national commitment that we have addressed in different ways. One example is the interstate highway system. We went up and made a commitment in 1946 or in the late forties to build an interstate highway system. Now the highway system is 30 years old and needs major repairs, but we haven't addressed how to repair it.

There are some today who are advocating paying for this out of a user fee. Well, we never paid for it in the first place totally with a user fee. Part of the financing came from a user fee, but we cannot depend upon that as the entire answer. I think it is important to get a mechanism to interrelate these sorts of things and get moving.

I think what the Congress did a week ago, in terms of the accelerated public works, was a very minor step. I think we have to take these short-term steps. But it seems crazy that we don't spend any money now, and instead cut back the budget for water, for synfuels, and for everything else that we know are long-term problems.

We have millions of people unemployed, and we are unwilling to take even the smallest steps to address these problems. I must say that I am as concerned as Mr. Byrom. I see this Congress next year facing a budget that, if it doesn't change its ways from last year, will make additional cuts in public works programs, in water, synfuels, and the rest that will aggravate our problems rather than solve them.

And yes, they are doing it within an aggregative approach rather than evaluating the specifics of where we need to go with our society's infrastructure, development, and economic growth.

Mr. BYROM. I am told there is a strong likelihood that the city of New York and the city of Boston will be very short of water in the near future, not because there are not water resources but because the distribution system is leaking so badly. Imagine the problem of replacing the distribution system for water in Boston and New York; that is just a small touch of what we are facing.

Mr. LUNDINE. He is more worried about the bridges in Pittsburgh.

Mr. BYROM. Well, I can understand why. [Laughter.]

Mr. LUNDINE. Mr. Magaziner, I just wanted to ask you one other question. During the course of some of the really interesting comments by Mr. Byrom, he said we were trying to deal with 1980 problems with 1940 institutions, and I think we both agree very strongly with that. I really want to compliment you for the degree of specificity you have about some of your recommendations. Whether you agree with every one or not, you can understand them and they are to the point, and they seem to be 1980-oriented, at least.

However, there is one that I don't understand. I understand your point, but I don't understand what you are recommending to do about it, even after rereading your detailed testimony. That is No. 7, regional incentives. Now, I don't want to pick on Pittsburgh, but it is always easier to pick on someplace other than your own area.

But indeed, if there is need to make the kind of adaptations that you have recommended, here you have an area that is two or three States, parts of two or three States, you have an area that is dominated by an industry that you say you have studied very well, and is obviously undergoing enormous change worldwide. You also have some of the most sophisticated technology anywhere in the world.

I am not saying what would you do for Pittsburgh, but when you say regional incentives and we must do something, my question is: What?

Mr. MAGAZINER. I agree with forming policies on a regional level or close to where they have an effect, but I think a lot of our industrial problems are national problems. We can't solve the steel problem on a regional basis because each region will want to keep its own plants and we won't get the right mix.

We need a national policy where one can take a national perspective, to say for example that this area in Ohio or that area west of Pittsburgh currently has high unemployment and it seems that a number of firms are in trouble there now, and what shall we do about it? We might find there are 50 areas of the country, SMSA's, just small pieces of different States, that are suffering that same kind of fate because of normal movements of capital.

Where such situations exist, we must develop policies to meet them. There are certain cases where in a sense we encourage companies to move because the company itself doesn't have to bear the social costs of doing so. A company considering building a new plant might go through the following reasoning:

> My current plant is 100,000 tons, that is outmoded, I must build a 500,000 ton plant, where should I put it? Should I build it next to my current plant? Well, maybe not, because if I can build it in another State, they will give me all kinds of incentives to come there; they will give me tax breaks in that State, and maybe it has a lower labor cost base and I will have a less senior labor force if I go there, so if I close my plant here and go there, I can cut my labor costs.

We encourage that thinking and the original State picks up the bill for all the people laid off, and the new State picks up the bill for inducing you to come there. I think that is a wasteful way to use resources.

Again, the public ROI differs from the private ROI. We should encourage companies, if they are going to make an expansion or investment, to do it where they are now rather than moving.

The second thing I think we ought to do, and this has been successful in some countries in Europe, is to have an effective regional policy where we recognize that a certain region is suffering way above the national average and that this is likely to continue. Certainly we can see a lot of that in the Midwest now, we should provide some inducements for firms that are making new investment decisions to in fact locate new facilities there.

I don't think we can do that with just tax incentives because they are not sufficient. What other countries do is pay as much as 40 or 50 percent of the capital costs, in some cases, of constructing the plant in order to get it in certain regions defined as depressed regions. I don't suggest we go that far, but I think we ought to provide some meaningful incentives.

I think we could do this politically, maybe not at the House level but at the Senate level, because almost every State has certain districts or certain areas that would qualify. We could designate those areas according to a sliding scale based upon percent over the national average of unemployment or percent of wage level lower than the national average wage levels or some measure like that, and then put some incentives with teeth behind them to get an allocation of private capital investment toward those areas. That would be that kind of program I would advocate.

Mr. LUNDINE. I think one criteria for judging a hearing is how interesting it is and the focus you are able to gain. This has been very valuable to me both because I think it has enabled me to get a better focus on what is clearly one of the great problems facing this country but also because it expanded my vision. I never until today thought of abolishing the State of Pennsylvania. [Laughter.]

I will pass that suggestion on to my colleague, Mr. Ertel.

Mr. BYROM. I don't know how you feel in upstate New York about the viability of the Big Apple.

Mr. LUNDINE. There are a good many people in my State who have the feeling that we would be better off if we floated the downstate out to the Atlantic Ocean, but I am not one of those. [Laughter.]

These hearings will be adjourned for today. I assure you that we intend to do what we can at the very least to clarify and bring into sharper focus this problem, and hopefully over time and with a dedicated, consistent effort, to do something about that problem.

Thank you all for spending your time here.

Mr. BYROM. May I make a suggestion?

Mr. LUNDINE. Yes.

Mr. BYROM. What would happen if you tried to establish some informal fora with the three of us and whoever others you might want to add with your staff where we can talk out loud about what our problems are?

Mr. WILLIAM COYNE. First of all, I would like to respond to that. I commend you for asking for the extra time to make that suggestion. It was something I was going to attempt to do earlier, and I think it would be a great idea.

Mr. BYROM. We need dialog.

Mr. WILLIAM COYNE. If we leave here today knowing that we have identified that we don't know the problem and hold additional hearings, call additional witnesses in, I think that is a great suggestion that you have made.

Did you hear that, Stan?

Mr. LUNDINE. Yes, I do, too, and as the minority counsel has reminded me, we actually did start that with the CED. We had a meeting or two over in the Madison Building about a year ago, I guess it was, and I agree. What we are trying to do is develop ways of solving problems to which, frankly, not only is our term of office inappropriate and, as has been suggested, maybe our district scopes are inappropriate, but the hearing process of Congress is clearly inappropriate.

Mr. BYROM. Exactly.

Mr. LUNDINE. You know, the problem to some extent are people schedules and things like that, but it is an intriguing notion and I think I will take you up on it. We may get back to CED and use this subcommittee and its staff and the Committee for Economic Development, and I don't mean to volunteer the AFL-CIO.

Mr. BYROM. I was going to say that one of the problems with CED is that by its charter, it does not include labor; so that we need to have something where we can sit down across the table and have dialog with labor present.

Mr. LUNDINE. I agree.

Mr. BYROM. And what I am thinking about goes back to the point where I felt that people of like mind can find an informal way of making a formal system that won't work work.

Mr. LUNDINE. Yes.

Mr. BYROM. And I would like to be a party to it.

Mr. LUNDINE. Yes. Thank you very much. I would, too.

The subcommittee hearing is adjourned.

[Whereupon, at 12:25 p.m. the hearing was adjourned.]

[The following statements were received by the subcommittee for inclusion in the record:]

STATEMENT OF
DOUGLAS A. FRASER, PRESIDENT
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)
SUBMITTED TO THE
SUBCOMMITTEE ON ECONOMIC STABILIZATION
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
ON U.S. INDUSTRIAL STRATEGY

October 22, 1982

I appreciate this opportunity to present the views of the UAW on the subject addressed by this hearing, and by Congressman Lundine's proposed legislation. Our Union's 1.2 million members — and the hundreds of thousands of members we have lost since 1979 — are front-line victims of this nation's dismal failure to develop and implement a coherent industrial strategy. In a rapidly changing global environment, in which virtually every other developed and industrializing government acts decisively to chart their nation's economic course, our economic future will continue to dim until we confront and surmount our unwillingness to plan. By calling attention to this vital national need, Congressman Lundine's bill performs the important service of advancing the level of public awareness and debate.

The U.S. economy is at a crossroads. The long postwar boom has given way to a decade of near-stagnation, capped in the last three years by actual economic decline. To restart the stalled engine of growth will require far more careful targeting of resources to achieve planned, mutually-agreed outcomes which address the interests of all segments of our society, not just a privileged few. The costs of our nation's economic policy failures are frightening, and mount daily. The current 31% level of idle capacity means that we are foregoing output of some $350 billion a year. Whole industries are operating at half-speed or even less. Domestic car production is half what it was in 1978, contributing to the collapse of supplier industries such as machine tools and steel.

At just the time when a targeted approach to reindustrialization is needed, we instead get massive across-the-board business tax cuts, with no requirement that this huge windfall to corporations be utilized for productive job-creating investment. At just the time when government urgently needs resources to make large-scale infrastructure and other investments on which future growth depends, ill-advised and mean-spirited budget cuts force reductions in these and other categories of non-defense public spending. The enormity of our problems and their tragic human costs are too great to allow the economy to continue to drift, in blind hope that it will repair itself spontaneously. First and foremost in ending this drift, we must call a halt to monetarism and trickle-down economics: the U.S. isn't rich enough to fight inflation with deindustrialization, at the staggering cost of $200 billion in lost GNP per 1% reduction in the rate of increase of consumer prices via induced recession.

But putting a stop to monetarism — though vital — will not be enough. To resolve our perplexing structural economic dilemma will require — among other things — adoption and implementation of a coherent industrial policy. The goals of that policy must go beyond improved "competitiveness," to encourage promotion of decent, remunerative and secure employment, community stabilization, and enhancement of the economy's capacity to produce and equitably distribute a steadily rising standard of material well-being for our nation's people.

Moreover, in keeping with this nation's cherished democratic values, industrial policy must be developed and implemented on the basis of the widest possible public discussion, participation and debate. Decisions of this magnitude are far too important to be left to a tiny, unaccountable corporate or technocratic elite.

Too much of the public debate about industrial policy has been cast in a narrow and misleading framework which seeks to "pick" between existing basic industry and "sunrise" sectors. This less-than-useful distinction overlooks the fact that policy itself — both of our government and other nations — is often the main determinant

of where the "sun" rises and sets. We cannot afford to forsake basic industry, nor to forego a competitive high technology sector. To rebuild the economy requires help to both. Writing off one while favoring the other would leave us with a lopsided economy; our nation could not prosper nor even long survive solely as a purveyor of McDonald's hamburgers and computer chips. The decline of manufacturing as a necessary source of employment has been greatly overstated; service sector employment in many regions is and will long remain heavily dependent on the local manufacturing base.

The tools of industrial policy must therefore be adequate to the task of revitalizing basic industry and encouraging new high-technology growth. Research and development subsidies, and more public R&D — perhaps administered under the auspices of a new "National Civilian Technology Administration" — are especially appropriate to smaller high technology firms. Loans, loan guarantees, targeted procurement, and direct public investment make sense for a national program to revitalize battered metalworking industries.

Not choosing "winners" and "losers" does not mean that all industries should grow or contract at the same rate. It is probable that once a democratic and accountable planning mechanism has been developed, certain industries would not be deemed appropriate candidates for publicly-subsidized or guided restructuring. But even in these cases, there is a critical role for industrial policy, to manage the rate at which such sectors will be allowed to decline. The nation can afford to have some industries suffer gradual employment losses while others enjoy gradual gains; but we cannot afford to have entire industries, communities, and regions shrink at an uncontrolled and calamitous rate, while "boomtowns" elsewhere struggle to provide infrastructure, housing, and services. America is paying far too high a price for abandoned schools, vacant unsold housing, and closed factories in Detroit and for their crash program duplication in Houston.

Social Accounting

These costs, while immense, don't show up on any private balance sheet. The CBO reports that each one percent of unemployment costs the federal government $25 billion. A more complete accounting would "charge" unemployment with extra crime, drug use, divorce, underemployment, and suicide as well. The BLS says that each auto job is connected to 2.36 supplier jobs. Each one percent rise in the trade-weighted exchange rate of the dollar costs the U.S. so many jobs, tax receipts, etc. We don't make it our business to do social accounting, and we seldom base policy on it. Yet that's what is called for in a world in which decisions made — or not made — behind closed boardroom doors and in other nations' capitals can have such massive social consequences.

Beyond social accounting, the federal government must greatly expand its capability and competence to plan on a par with the most successful of our international trading partners who are knocking our socks off in high-stakes global competition. As an important goal of that planning process we have to find ways to redeploy unused resources in hard-pressed communities. Instead of fanning the flames of socially irresponsible capital hyper-mobility, the tax code must be totally overhauled into an engine of economic revitalization and community stability, rather than one driving disinvestment and economic decline.

Plant closings must also be regulated as they are in virtually every other industrialized country, to protect workers and communities against their devastating impact and to slow the rate of economic decline. Industrial policy without plant closing legislation is like a car with a gas pedal but no brake; and without either, our economy is headed for a crash.

Policies affecting international trade and investment are an even more vital adjunct to industrial policy, for similar reasons. If utilized properly, trade policy can be an important lever by which government may promote effective restructuring

of beleaguered, import-damaged industries. Pending implementation of a more comprehensive set of industrial policies, continued failure to utilize trade policy to offset the deleterious impact of other nation's trade and industrial policies threatens to make jobs our nation's leading export.

Industrial strategy must also encompass the energy sector, which has such profound spillover effects on the rest of the economy. This does not mean a crash synfuels program or a crash solar program or a crash breeder reactor program; it means clarifying the direction of future energy use. It means **using policy to send the long-term signals that market prices don't:** that oil and gas should be reserved for their premium uses, with other demand supplied by coal, coal gas, and renewables.

Financing

Financing is another key element of industrial policy, requiring new public financial institutions and new sources of public and private capital.

As a first step, substantial funds for reindustrialization would be made available by ending the artificial "capital shortage" caused by monetarism. Credit availability and allocation are far too important to leave to an unaccountable Fed. Since restricted credit impacts different industries, sectors, and regions differentially, it constitutes a form — albeit a monstrous one — of industrial policy. It is hardly appropriate that a democratic nation lets a small group of non-elected bankers control so important an industrial policy.

Additional funds would also be freed up by restricting credit presently used to finance speculative mergers and takeovers. The tax code encourages vast amounts of such unproductive activity, and our so-called managerial talent wastes its time seeking takeover candidates instead of planning new productive investments. Funds that could be used for productive investment are bestowed upon stockholders as they sell to reap their windfall.

A major reordering of dangerously distorted budget priorities would provide yet another source of badly needed public capital. The Administration's unprecedented peacetime military build-up has diverted billions that could be used to rebuild our decaying infrastructure. Our depleted civilian economy simply cannot afford continued waste of resources on so massive a scale. Bloated military budgets are an important source of public capital with which to revitalize the economy and promote economic growth.

Additional capital could also be found by restoring the tax base — and some tax equity — by rolling back the tax cuts to high income Americans and by reversing more of the 1981 tax givebacks to corporations. This capital could be pumped right back into the economy in the form of a crash public works program to rebuild infrastructure needed for the long run, while providing thousands of urgently-needed jobs right now.

Pension funds — of private as well as public sector workers — can also be marshalled in the reindustrialization effort. What is needed is a public authority that could sell government-guaranteed "reindustrialization bonds" to pension funds (and, for that matter, to the general public). Once such an authority existed, unions could negotiate for a share of their members' funds to be invested in such bonds.

This by no means exhausts the list. We should take a hard look at some of the capital formation programs of Japan and the industrial countries of Europe, such as capital allocation through public banks, direct public investment and ownership, and others.

Other Policies

Other needed elements of a coherent industrial policy include:

- A **tripartite labor market board**, focusing on training and retraining, job search and relocation assistance, and enforcement of corporate obligations toward workers and communities impacted by economic change.

- An **industrial reconstruction administration** — a tripartite board — with authority to use targeted tax incentives, loans, loan guarantees, and other tools to assist older industries in need of modernization and new industries having difficulty obtaining financing. To minimize the social cost of economic change, such a board should encourage conversion and facility reuse rather than new "greenfield" development.

Legislative Vehicles

There are a number of proposals on U.S. industrial policy. All introduce at least some of the total policy that is needed, and all stimulate and advance the crucial national debate. H.R. 6099 would establish a quadripartite National Industrial Development Board to begin the important work of indicative and sectoral planning. H.R. 14 would set up a National Development Bank. H.R. 6000 would reestablish an RFC. There is also at least one bill, H.R. 6623, that would establish regional development banks.

With appropriate consolidation and further development, these legislative initiatives can form the basis for the necessary public debate over terms and institutions of a U.S. industrial policy that will be critical to our economic success in the years ahead. It is most unfortunate that in view of the urgency of the problems and the clear need for these kinds of solutions, greater public consensus — and in particular, corporate America's acceptance — has been so slow to emerge. For these important efforts under adverse and unrewarding circumstances, Congressman Lundine and his colleagues are to be greatly commended. Their foresight will ultimately be vindicated, hopefully before further permanent damage is done to our ailing economy.

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Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Subcommittee on Economic Stabilization of the Senate Committee on Banking, Finance and Urban Affairs in hearings on U.S. industrial strategy. October 21, 1982

(The U.S. Council for an Open World Economy is a private, non-profit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest.)

As virtually the sole spokesman for this position in the "liberal trade" community, I have long been advocating a coherent industrial adjustment and redevelopment strategy as an indispensable backstop in domestic economic policy for a coherent free-trade strategy in foreign economic policy. A convincing commitment to full employment should be one component of such a domestic strategy. Just as such an industrial strategy is essential (for political and other reasons) to securing and sustaining a definitive free-trade strategy, so a definitive free-trade strategy is essential to ensuring that efforts to strengthen the nation's industrial base aim at optimum utilization of the nation's resources and, in particular, at the most prudent, productive industrial redevelopment. Incidentally, a policy to make international trade totally free (to move toward this goal, with deliberate speed, on the part of the industrialized countries) is essential to making international trade totally fair -- just as making international trade totally fair is indispensable to making and keeping it totally free (or going as far as possible toward dismantling artificial trade barriers). Free trade and fair trade are one objective indivisible.

Free trade, or the prospect of free trade, will stimulate the best kind and rate of industrial and overall economic growth of which the American economy is capable. "Protectionism" (which I define as recourse to import control other than as a measure of last resort in a coherent redevelopment policy addressing the real problems of distressed industries) retards fulfillment of the nation's industrial and overall economic potential. Trade barriers as the sole or principal aid to distressed industries also retard development of the soundest response to the problems of these industries by diverting energies from the more laborious task of assessing the real needs of these industries and devising the best ways to address them in the context of the total national

interest. In virtually every instance where U.S. import restrictions have been imposed, these controls have not been integral parts of industry redevelopment strategies. Besides denying consumers the access they should have to the widest range of goods and services their tastes prefer and their budgets permit, and besides costing the nation billions of dollars every year, import restraints are costly in still another sense. They divert attention from the search for real solutions to the real causes of industrial weakness, and they deny other industries the freest access they should have (a) to equipment, components and materials they consider most suitable for most efficient production, and (b) to the most lucrative markets abroad -- access essential to maximizing productivity and profits, but not obtainable so long as our own market is not fully opened.

A free-trade premise -- at least the expectation of virtually free trade on the part of the industrialized countries by the end of this century -- should be factored into the planning of every company, union, state and locality, and into national policy formation affecting economic development. Such a premise would stimulate the greatest resourcefulness in our dynamic economy, and the best utilization of resources in every sense. Uncertainty about the extent and durability of the government's rhetorical espousal of "free trade" is little better than unmistakable protectionism as a trade-policy premise for industrial strategy. The current premise is more or less protectionist, made so in the first instance by the fact that, in practice, the government itself is ambivalent in this policy area (the tributes to market forces and open markets notwithstanding).

A free-trade premise for industrial redevelopment does not inherently mean the loss of many existing industries, not even those that are old and import-impacted. On the contrary, the industrial strategy I have in mind would stimulate technological and other innovations that could save old industries as well as spur and strengthen newer ones. It would generate more exports, reflecting not only the new spurt of aggressive U.S. competition but in response to the greatly expanded market opportunities which a free-trade commitment by participating industrialized countries would open up for the goods in which the U.S. economy at its best will excel. Markets in the world's developing countries will also improve accordingly. They are already of major importance in U.S. export trade.

National Economic Development Council

To make sure that sound industrial redevelopment and effective

adjustment to rapidly changing international realities are elevated to the priority they merit in national, indeed nationwide, policy, the federal government should establish a cabinet-level council on national economic development. The council should be chaired by the President and be equal in standing to the National Security Council. It should coordinate federal activities in the area of economic development and stimulate the most effective attention to these issues throughout our economy. Advisory committees should provide and stimulate incisive input from business, labor, state and local governments, and the public at large. Industrial strategy should be a major focus of the council's activities, consistent with developing a healthy, dynamic, private-enterprise system. America's future as an industrial power should not be left to the "invisible hand" of Adam Smith's economic doctrine, but nor should it be shaped and shepherded by the heavy hand of government.

The responsibilities of the inter-agency council I propose would include some of the functions listed by the AFL-CIO in its own proposal, and in those of H.R. 6099 and S. 2518. But I do not endorse these other proposals in their present form.

Import relief and industrial strategy

S. 201 of the Trade Act of 1974 should be reformed to require that any import-restrictive aid to a deserving industry must be cast within the framework of a coherent adjustment strategy for that industry, encompassing commitments by industrial management and the industry's labor force as well as by government. One of government's responsibilities should be reassessment of all statutes and regulations materially affecting the industry's ability to adjust effectively to the new market realities; any inequities should be corrected.

Such reform of the import-relief provisions of the trade legislation would make import relief one instrument of a coherent industrial strategy. Pending such reform of the trade law, the President currently has inherent authority to move toward developing a coherent industry-adjustment strategy as the framework for any import relief deemed justified for a distressed industry. However, there is no inclination anywhere in government for such innovation, nor anywhere in the "liberal trade" community outside the U.S. Council for an Open World Economy. In fact, a free-trade strategy per se, and a closely coordinated link between a free-trade strategy in foreign economic policy and a redevelopment, full-employment strategy in domestic policy, are also uniquely propositions emanating from our Council alone. America is seriously unprepared in both areas of public policy.

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